November 15, 2002

<u>VIA ELECTRONIC FILING</u>

The Honorable Magalie Roman Salas
Secretary
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, DC 20426

Re: *Remedying Undue Discrimination Through Open Access Transmission Service and Standard Electricity Market Design, Docket No. RM01-12-000.*

Dear Secretary Salas:

Attached for filing in the referenced proceeding is the Comments of the State of Michigan and Michigan Public Service Commission. If there are any problems with this filing, please contact the undersigned at (517) 241-6680. Thank you.

Respectfully submitted,

Patricia Barone
Assistant Attorney General

Enclosure

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Remedying Undue Discrimination Through	)	
Open Access Transmission Service and	)	
Standard Electricity Market Design	)	**Docket No. RM01-12-000**

COMMENTS OF
THE STATE OF MICHIGAN AND
MICHIGAN PUBLIC SERVICE COMMISSION

Jennifer M. Granholm
Attorney General
of the State of Michigan

David A. Voges (P25143)
Steven D. Hughey (P32203)
Patricia S. Barone (P29560)
Assistant Attorneys General
6545 Mercantile Way, Suite 15
Lansing, Michigan 48911-5984
Phone (517) 241-6680

November 15, 2002

TABLE OF CONTENTS

EXECUTIVE SUMMARY
FOR THE COMMENTS OF THE STATE OF MICHIGAN
AND MICHIGAN PUBLIC SERVICE COMMISSION

Michigan strongly and emphatically supports issuance of a final rule which achieves a standardized market for transmission and energy services grounded on the principle that bilateral contracts entered into between buyers and sellers constitutes the foundation of the SMD proposal. Michigan shares the Commission's findings that industry activity since the issuance of Order Nos. 888 and 2000 has demonstrated the need for mandatory measures to achieve the goal of non-discriminatory transmission access. Michigan has experienced first-hand the problems created by seams and can attest to the fact that it is virtually impossible to eliminate seams on a voluntary basis as long as the existence of such seams insulates the generation interests of vertically integrated utilities from competition.

The centerpiece of the Commission proposal is a new network transmission service with standardized terms and conditions, coupled with a standardized spot market for day-ahead and real time sales of electricity. Adoption of a standardized transmission tariff for use by all RTOs and a standardized spot market is essential to the development of a seamless national open access transmission system and nationwide wholesale market for sales of electricity.

The requirement that all load-serving entities utilize the new transmission service to serve their bundled retail customers is essential in order to define the transmission rights of bundled retail sales service. The Commission proposes to achieve this objective with a congestion management system under which customers are able to obtain firm service by paying congestion charges on constrained transmission lines. LMP will be used to determine congestion pricing and should serve to encourage more efficient allocation of transmission. CRRs are a crucial feature of the congestion management proposal that will enable customers to hedge transmission congestion prices. Implementation of congestion management must be undertaken in a manner which provides native load-serving entities with sufficient CRRs to satisfy their state-imposed obligation to serve, including future load growth that existing capacity was built to serve. Michigan urges the Commission to make every effort to preserve the working relationship between the unbundled and the bundled states by taking all available actions to ensure that the quality of the existing bundled transmission service is not degraded.

Michigan does not support the expansion of functions performed by Independent Transmission Companies ("ITCs"), either though operation of ITPs or assignment of functional control over a wide range of ITP or RTO functional responsibilities, beyond that provided in *TRANSLink*, 99 FERC ¶61,106 (2002).

Michigan strongly supports the proposed market monitoring and market power mitigation features of the proposed rule. Experience with market-based bid markets demonstrates the importance of monitoring market behavior generally, as well as individual situations, for indications of the exercise of market power. It is essential that the Commission provide assurances that market-based prices will remain at just and reasonable levels as judged by competitive market pricing standards.

The Commission has properly recognized the importance of adopting a resource adequacy requirement to ensure development of infrastructure needed for reliable transmission operations. The development of a regional resource adequacy requirement will be a challenge because states have jurisdiction over most aspects of electric energy planning and understandably are hesitant to part with or share this responsibility. In this respect, the Commission must accommodate differences among the states and focus upon mechanisms to ensure that the benefits follow the loads that undertake the investment in resource adequacy.

Michigan applauds the Commission's effort to elevate the role of state commissions in the formation and operation of RTOs. In particular, Michigan strongly endorses the efforts by the Commission to work with the states on energy infrastructure siting and broader regional planning issues.

The Commission has appropriately identified an expanded role for demand response in the SMD proposal. Michigan concurs that price response and proactive demand management initiatives are currently underdeveloped and must be tapped aggressively if customers are to realize the full potential of competitive market restructuring envisioned by the SMD initiative. It is critical that the various elements of the rule affecting demand response be synchronized to ensure that demand response options are fully developed without any undue preference towards "old-line" utility solutions.

Michigan recognizes the importance of consistent, comprehensive, and contemporaneous implementation of most elements proposed within the SMD. Clearly, a core of market functions must be incorporated at the out set of SMD rollout to achieve success. However, as we discuss in our comments, not all elements of the FERC proposal need to be initiated on day one. Some features may be best introduced over time because they are not time sensitive, implementation resources are limited, or, for some features, further research and discussion could be significantly beneficial.

While Michigan recognizes that nationally uniform standards for the operation of wholesale electricity markets are a desirable goal, realization of these goals must be tempered by the realities of the day. Regions across the country are different and therefore are not given to a single, simultaneous solution to any issue. Applying one SMD to all regions and states of the country, simultaneously, may result in significant delay for all parties, caused by appeals and litigation. Instead, Michigan urges the Commission to consider a regional approach to implementation of the SMD with initial efforts concentrated in the MISO-PJM region.

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Remedying Undue Discrimination Through	**)**	
Open Access Transmission Service and	**)**	
Standard Electricity Market Design	**)**	**Docket No. RM01-12-000**

COMMENTS OF
THE STATE OF MICHIGAN AND
MICHIGAN PUBLIC SERVICE COMMISSION

The State of Michigan and The Michigan Public Service Commission (collectively "Michigan") hereby submit their initial comments on the Notice of Proposed Rulemaking on Standard Market Design ("SMD NOPR") issued in the captioned proceeding on July 31, 2002.

I. INTRODUCTION

The State of Michigan is a sovereign state of the United States and files these comments in its *parens patriae* capacity to preserve and protect the health, safety and welfare of its citizens; and in its proprietary capacity as a substantial purchaser of electricity.

The Michigan Public Service Commission is an agency of the State of Michigan, created by 1939 Pub. Acts 3, Mich. Comp. Laws Ann. § 460.1 *et seq.;* Mich. Stat. Ann. - 22.13(1) *et seq.,* having jurisdiction and authority to control and regulate rates, charges, and conditions of service for the local distribution and retail sale of electricity in the State.

Michigan is vitally interested in matters involving the provision of electric service to citizens located within its borders and the rates to be charged Michigan utilities and their customers. Michigan thus has a direct and vital interest in this proceeding and its participation is in the public interest.

II. SUMMARY AND OVERVIEW OF COMMENTS

By the instant rulemaking, the Commission is continuing its strong leadership role that is essential to the development of an integrated electric transmission grid and a competitive wholesale market to meet and more effectively manage our nation's demands for electric energy. The SMD NOPR sets forth a comprehensive plan to establish robust competitive wholesale markets through provisions designed to foster efficient transmission systems, respond to proper pricing signals and provide incentives to encourage investment in transmission, generation, and demand response options and infrastructure, along with provision of more customer choices to meet consumer energy needs.

The Commission initiated the first step towards the development of competitive markets by the issuance of Order No. 888,[1] which required all public utilities to offer open-access, non-discriminatory wholesale transmission service under standardized *pro forma* tariffs. In 1999, the Commission issued Order No. 2000,[2] which set the foundation for the formation of Regional Transmission Organizations ("RTOs"). To encourage participation and innovation, the Commission provided parties in the various regions of

[1] *Promoting Wholesale Competition through Open Access Non-Discriminatory Transmission Services by Public Utilities – Recovery of Stranded Costs by Public Utilities and Transmitting Utilities,* FERC Stats. & Regs. 1991-1996 (1996) ¶ 31,036 ("Order No. 888").
[2] *Regional Transmission Organizations*, FERC Stats. & Regs. ¶ 31,089 (1999) ("Order No. 2000").

the country maximum flexibility to design regional transmission rates and related energy markets. As a result, Independent System Operators ("ISOs") and RTOs are functioning in several regions of the country under different transmission rate designs and energy markets. Experience with these various operating models has provided the Commission and the industry with the opportunity to analyze what works, and what does not.

While much progress has been made, operating experience demonstrates there remain significant impediments to the development of fully competitive markets. Mainly, the existence of inconsistent transmission rate designs and inconsistent rules for short-term energy markets have discouraged the development of inter-RTO competition. In addition, there are conflicting state and federal rules governing access to interstate transmission capacity. Moreover, the incumbent transmission owners have continued to discriminate in favor of their generation affiliates.

To remedy these problems, the Commission is proposing a standardized transmission service, coupled with a standardized wholesale electric market design which includes market monitoring and market mitigation functions. Independent Transmission Providers ("ITPs") will be responsible for administering open access transmission services and the wholesale market for sales of electricity. Existing RTO and ISOs will qualify as ITPs if they can demonstrate they have no direct or indirect interest in any market participant. Those entities that do not belong to an RTO would be required to appoint an ITP to implement the standardized transmission service and energy markets. The standardized transmission service would be provided by RTOs and ITPs to all load, including bundled retail sales service.

Michigan has long shared the Commission's vision of open access transmission service and competitive markets for sales of electric energy. To achieve this vision, Michigan has consistently supported the Commission's initiatives to promote a competitive wholesale market. In addition, Michigan has implemented legislative and regulatory initiatives to promote retail competition in the State of Michigan. Michigan's Customer Choice and Electricity Reliability Act (2000 PA 141; MCL 460.10 *et seq*.) was enacted by the legislature and was signed by Governor John Engler in June 2000. In the months that followed, Michigan issued the necessary orders to implement the new law. Full open access began in Michigan on January 1, 2002, and there are presently almost 5,000 customers participating in electric customer choice programs in Michigan, representing about 1,500 MW or roughly 7.5% of the state's total load.

Michigan has consistently supported the Commission's efforts to increase access to the transmission grid and the competitiveness of the electric generation market. Michigan filed comments supporting the issuance of Order No. 888. Subsequent to the issuance of Order No. 888, Michigan actively promoted and participated in the formation of an ISO to serve the Midwest. For example, in August 1999, the Michigan Commission joined with eight other state commissions to support the timely development of RTOs.[3] When the momentum initiated by Order No. 888 began to fade, with little to show after several years of effort, the Commission issued Order No. 2000, which

---

[3] *Initial Comments of the Nine State Commissions Representing the East-Central/Midwest/Southwest (ECMS) Region*, Docket No. RM99-2-000, August 23, 1999. In addition to Michigan, the state commissions represented included Pennsylvania, Virginia, Ohio, Indiana, Illinois, Missouri, Arkansas, and Oklahoma.

required all public utilities either to join an RTO by December 31, 2001, or explain why they had not done so. The issuance of Order No. 2000 achieved its immediate objective of requiring public utilities, state commissions and all stakeholders to engage in a collaborative process to determine whether RTOs of sufficient geographic scope could be voluntarily formulated to serve the Midwest and other parts of the county. Michigan played a lead role in this effort. On March 2, 2000, Commissioner Robert Nelson presented a "Midwest Alliance" Strawfigure Proposal at the Cincinnati Workshop which explored ways to bring the then-proposed Alliance RTO together with the Midwest ISO. On May 3, 2000, in Detroit, the Michigan Commission sponsored the first of several meetings hosted by state commissions in the Midwest to bring together Midwest stakeholders and senior FERC staff. The product of that meeting was a list identifying major issues that needed resolution in order for a seamless market to develop in the region. These major issues, in significant part, are addressed in the SMD NOPR.

As the lead state commission among the MISO Advisory Committee members for 2001, the Michigan Commission worked in tandem with our regional colleagues to reach the MISO/Alliance Settlement Agreement that was approved by the Commission on March 21, 2001[4]. The Settlement Agreement permitted the formation of two RTOs, and provided for an Inter-RTO Cooperation Agreement ("IRCA") that would develop a seamless market in the region covered by the Alliance RTO and the Midwest RTO.[5] In addition, the Commission required the two RTOs to form independent boards and to initiate a stakeholder process to expand their IRCA with neighboring RTOs to address

[4] *Illinois Power Co*., 95 FERC ¶ 61,183 (2001).
[5] *Id*.

and eliminate seams.[6] While eventually made moot by subsequent events, this Settlement Agreement was a significant step in the evolution of the Midwest electricity market.

Unfortunately, neither the Order No. 2000 collaborative process nor the MISO/Alliance Settlement Agreement produced satisfactory results in the Midwest. Instead of one large Midwest RTO (or two seamless RTOs), the Alliance Companies and the Midwest ISO competed against each other in forming separate transmission organizations. The end result was a patchwork of service areas with RTO boundaries that made no geographic sense and created barriers to the development of a competitive wholesale market for electricity across the Midwest region.

On November 30, 2001, Michigan joined with fourteen other state agencies in responding to the Commission's November 9, 2001 letter which contained several questions related to RTO formation in the Midwest. The Midwest state commissions filed comments[7] with the Commission which outlined in detail why multiple RTOs managed through seams agreements "has not worked and will not work in the Midwest", as evidenced by the fact that little progress had been made on implementing the IRCA. Moreover, Michigan and the other commissions outlined the problems caused by a lack of independence during the start-up phase.

On December 20, 2001, the Commission once again exhibited superb leadership by rejecting the Alliance RTO and requiring the Alliance Transmission Owners to file a statement of their plans to join an RTO.[8] The Commission's detailed discussion of the multitude of problems caused by a lack of standardized RTO protocols provides

---

[6] *Alliance Companies, et al.*, 96 FERC ¶ 61,052, at 61,135 (2000).
[7] RT01-88, *et al.*, 96 FERC ¶61,052, at P 61,135 (2000).

compelling evidence demonstrating that the failure to standardize the RTO transmission tariffs and related energy markets has created an unworkable process which will leave incumbent utilities with the ability to favor their own generation by discriminating against competitors in neighboring RTOs.[9] Such discrimination can be achieved by creating and maintaining seams which act as barriers to entry. Michigan spent two years attempting to resolve seams issues with incumbent utilities that lacked independence from generation interests. The process does not work and cannot be relied upon to eliminate discrimination against entry and preference for incumbent generators.

There is also substantial evidence that a continuation of the *status quo,* under which RTOs either are not operating at all or are operating under inconsistent transmission and energy market rules, is causing consumers to incur unjust and unreasonably high costs. This is demonstrated by the Economic Assessment of RTO Policy, prepared for the Commission by ICF Consulting. That study estimates that the establishment of nationwide RTOs with consistent and effective market rules could result in $1-$10 billion per year in economic gains. In addition, a study prepared by Energy Security Analysts, Inc. entitled "Impact of the Creation of a Single MISO-PJM-SPP Power Market" concluded that the establishment of a MISO-PJM-SPP common market will cause a modest redirection in spot energy prices, and a less volatile energy platform which will yield more significant reductions in the prices of long-term energy contracts. While recognizing the difficulty in assessing the extent to which the development of a single market will hasten the processes whereby the forward price no longer carries a large premium versus the spot price, if the effect were as little as

[8] *Alliance Companies, et al*., 97 FERC ¶61,327 (2001).
[9] *Id*. at P 62,529-530.

$1/MWh for one year, the annual savings would be $1.7 billion (assuming all consumers hedge).[10]

Based on the foregoing evidence of the problems in dealing with inconsistent market rules and the benefits which could be derived if consistent rules were implemented across RTOs, Michigan strongly and emphatically supports issuance of a final rule which achieves a standardized market for transmission and energy services that are grounded on the principle that bilateral contracts entered into between buyers and sellers constitute the foundation of the SMD proposal. While Michigan recognizes there may be differing viewpoints (including our own) regarding various provisions of the SMD proposal and the mechanics of its implementation, the Commission must hold fast to five essential elements of the proposed rule:

1) a standardized, non-discriminatory transmission tariff;
2) a mechanism for defining and allocating capacity rights of all load, including bundled retail;
3) standardized energy market rules;
4) market monitoring and mitigation; and
5) RTO/ITP independence.

Adoption of these five concepts will provide the foundation for a competitive market structure. Michigan's comments below further discuss in detail the specific elements and issues which should be addressed in the final rule. An overview of these comments is set forth immediately below.

The centerpiece of the Commission is proposal is a new network transmission service with standardized terms and conditions, coupled with a standardized spot market for day-ahead and real time sales of electricity. Experience has demonstrated that each RTO cannot be allowed to adopt its own set of unique rules governing transmission and sales of electric energy in wholesale markets. The resulting seams interfere with interstate commerce across RTO. Adoption of a standardized transmission tariff for use by all RTOs and a standardized spot market is essential to the development of a national open access transmission system and nationwide wholesale market for sales of electricity.

Pursuant to the Commission's directive, the MISO and PJM stakeholders and interested state commissions have been meeting to eliminate seams between the two RTOs in the MISO-PJM single market initiative. Michigan strongly supports the MISO-PJM Single Market Design initiative and applauds the direct support the Commission has provided to help move this important cooperative regional venture forward. The issuance of the NOPR by itself has provided much needed guidance which has contributed to the significant progress made to date towards the objective of a seamless, standardized market stretching from the East Coast to the Midwest, including the footprint of the Southwest Power Pool ("SPP").

The issuance of a final rule will build upon the MISO-PJM-SPP single market initiative and expand its benefits by establishing a comprehensive plan for developing a nationwide competitive market for electricity with appropriate incentives which balance the need to expand our nation's electric infrastructure and to manage the projected growth in demand so as to encourage more efficient consumption.

One of the more controversial aspects of the proposed rule is the extension of Commission jurisdiction over the transmission element of bundled retail sales and the requirement that all load-serving entities utilize the new transmission service to serve their bundled retail customers. Such a requirement is essential in order to define the

---

[10] *See Impact of the Creation of a Single MISO-PJM-SPP Power Market*, prepared for MISO-PJM-SPP by Energy Security Analysts, Inc. (July 2002).

transmission rights of bundled retail sales service. Under the *status quo*, load serving entities have an obligation to serve the full requirements of existing customers, including load growth. Absent Commission action, the undefined growth rights of native load would likely lead to curtailments of firm wholesale transmission service. Michigan is convinced that the Commission must establish a mechanism for defining the capacity rights used to serve bundled retail load, and that this must be done in a way which guarantees no degradation of service to bundled retail customers.

The Commission proposes to achieve this objective with a congestion management system under which customers are able to obtain firm service by paying congestion charges on constrained transmission lines. The revenue from congestion payments would be paid to holders of congestion revenue rights ("CRRs"). Michigan submits that the implementation of congestion management must be undertaken in a manner which provides native load-serving entities with sufficient CRRs to satisfy their state-imposed obligation to serve, including future load growth that existing capacity was built to serve. Michigan has been working to develop a competitive wholesale market hand-in-hand with a large number of Midwestern states, including those that have chosen to retain traditional bundled retail service. Michigan urges the Commission to make every effort to preserve this working relationship between the unbundled and the bundled states by taking all available actions to ensure that the quality of the existing bundled transmission service is not degraded.

Michigan does not support the expansion of functions performed by Independent Transmission Companies ("ITCs"), either though operation of ITPs or assignment of functional control over a wide range of ITP or RTO functional responsibilities, beyond that provided in *TRANSLink*, 99 FERC ¶61,106 (2002). In particular, the FERC proposal to allow ITCs to serve as ITPs would be a huge mistake. ITCs fail the all important independence requirement, the bedrock principle for oversight of wholesale market operation. They have a vested interest in transmission. SMD will not be advanced through these proposals.[11]

RTOs must have exclusive responsibility to independently develop and manage wholesale markets in the Midwest region. The RTO structure, although not perfect, is working in the Midwest. It is gaining stature and confidence among the various stakeholders in the region. To change now could thwart the momentum currently underway. The Commission should abandon support for any proposals to increase the delegation of functions to ITCs. Such action would undermine RTOs and the progress in wholesale market development they have helped to foster. RTOs, under oversight of both the federal and state commissions, are the appropriate structure to successfully accomplish the objectives of the SMD.

Michigan strongly supports the proposed market monitoring and market power mitigation features of the proposed rule. Experience with market-based bid markets demonstrates the importance of monitoring market behavior generally, as well as individual situations, for indications of the exercise of market power. It is essential that the Commission provide assurances that market-based prices will remain at just and reasonable levels. The goal should be to minimize the amount of after the fact behavior

---

[11] For purposes of clarity throughout this document, the term "Independent Transmission Provider" ("ITP") will be used interchangeably with the term "Regional Transmission Organization" ("RTO"). However, this term will *not* be used when discussing an "Independent Transmission Company" ("ITC"). The Commission has clearly stated that an ITC lacks sufficient form (i.e. scope, configuration, independence, etc.) to stand-alone and has thus, carved out a niche for these entities under the "umbrella" of the larger ITP authority.

that has to be monitored through the establishment of standards of conduct and competitive benchmarks before bids are made.

The other critical pieces of the proposed rule are long-term resource adequacy and long-term planning. The Commission has properly recognized the importance of adopting a resource adequacy requirement to ensure development of infrastructure needed for reliable transmission operations. The development of a regional resource adequacy requirement will be a challenge because states have jurisdiction over most aspects of electric energy planning and are understandably hesitant to part with or share this responsibility. In this respect, the Commission must accommodate differences among the states and focus upon mechanisms to ensure that the benefits follow the loads that undertake the investment in resource adequacy. The critical issue is whether the SMD NOPR adequately provides the necessary regulatory structure to attract the capital to invest in needed infrastructure. Michigan is confident that a final rule can be developed which meets this critical objective.

Michigan applauds the Commission's effort to elevate the role of state commissions in the formation and operation of RTOs. In particular, Michigan strongly endorses the efforts by the Commission to work with the states on energy infrastructure siting and broader regional planning issues. A strong role on these matters, through both the Multi-State Entities proposed by the National Governors Association[12] and the Regional State Advisory Committees ("RSACs") proposed by the Commission, is a key ingredient (1) to the solution to our infrastructure problem; (2) the development and oversight by the Commission of competitive wholesale markets; and (3) the development

---

[12] "*Interstate Strategies for Transmission Planning and Expansion*," a report from the National Governors Association's Task Force on Electricity Infrastructure issued July 18, 2002.

of competitive retail markets in those states that have determined retail customers should have access to unbundled retail transmission service and the right to choose a competing supplier.

The Commission has appropriately identified an expanded role for demand response in the SMD proposal. Michigan concurs that price response and proactive demand management initiatives are currently underdeveloped and must be tapped aggressively if customers are to realize the full potential of competitive market restructuring envisioned by the SMD initiative. It is critical that the various elements of the rule affecting demand response be synchronized to ensure that demand response options are fully developed without any undue preference towards “old-line” utility solutions. In this respect, Michigan notes that demand response will not be advanced by proposals which delegate more functions to ITCs than the Commission has allowed in *TRANSLink, supra*. To the contrary, demand response, along with other options competing with transmission, will, be discriminated against if ITCs are granted super participant status in the decision making process for wholesale market management and oversight. More detailed discussion of demand response, including proactive demand side management, and its importance to the SMD initiative, is provided below in a later section of Michigan’s comments.

While Michigan recognizes that nationally uniform standards for the operation of wholesale electricity markets are a desirable goal, realization of these goals must be tempered by the realities of the day. Regions across the country are different and therefore are not given to a single, simultaneous solution to any issue. Furthermore, the regions, like the states they reflect, seek to protect their rights of self-determination, based on their perceived best interest. Thus, regions should neither be allowed to accelerate nor impede the progress or course of direction of other regions.

A number of states and regions in the country are prepared and eager to move forward with the general direction and broad concepts incorporated in the Commission's SMD NOPR, but like Michigan, are expecting improvements to many specific provisions in the final rule. On the other hand, a number of other states and regions in the country are not prepared to move forward with any or all of the concepts incorporated in the Commission's SMD proposal. Applying one SMD to all regions and states of the country, simultaneously, may result in significant delay for all parties, caused by appeals and litigation. Instead, the Commission should respect regional differences and craft a final rule which does not impose a singular solution across all regions simultaneously. Developing mutually acceptable plans and schedules with the various regions will require greater initial effort, but will ultimately produce faster and more satisfying results. This approach would create partners, rather than litigants, and would provide natural benchmarks for measuring successes and failures as the regions move at differing paces. Michigan urges the Commission to consider a regional approach to implementation of the SMD with initial efforts concentrated in the MISO-PJM region.

The Commission highlights in the NOPR the difficulties that are presently operating in competitive electricity markets due to lingering uncertainties.[13] Michigan agrees that "unprecedented uncertainty about, and lack of confidence in, today's electric markets"[14] are hindering all market players – suppliers, marketers, and customers alike – from participating more fully in competitive energy markets and thereby obtaining the

---

[13] NOPR at P 96, 97, 98.
[14] *Id.* at P 96.

benefits that true competition promises. Michigan agrees that "uncertainty about the direction of competition policies inhibits the development of the very infrastructure needed both to allow competition to work and to assure reliability in a competitive environment."[15] These circumstances highlight the importance for completing the deliberations on SMD and putting into place final rules that will reduce uncertainty by providing sufficient mechanisms to establish fair market rules and insure adequate market oversight.

III. NEED FOR REFORM

Michigan shares the Commission's findings that industry activity since the issuance of Order Nos. 888 and 2000 has demonstrated the need for mandatory measures to achieve the goal of non-discriminatory transmission access. Michigan has experienced first-hand the problems created by seams and, as explained in the summary, *infra*, has been actively involved in eliminating seams between the Midwest ISO and the Alliance RTO. Therefore, Michigan can attest to the fact that it is virtually impossible to eliminate seams on a voluntary basis as long as the existence of such seams insulates the generation interests of vertically integrated utilities from competition.

On November 30, 2001, Michigan and fourteen other state agencies filed joint comments with the Commission explaining why multiple RTOs managed through seams agreements "has not worked and will not work in the Midwest." These comments also outlined the problems caused by a lack of independence during the start-up phase of an RTO.

On December 20, 2001, the Commission exhibited superb leadership by rejecting the Alliance RTO and requiring the Alliance Transmission Owners to file a statement of their plans to join an RTO.[16] The Commission's detailed discussion of the multitude of problems caused by a lack of standardized RTO protocols is set forth below:

> Our earlier finding regarding the adequacy of the scope of the Alliance RTO relied, in part, on implementation of the IRCA, which was intended to provide the basis for a seamless market in the territories served by the Midwest ISO and the Alliance RTO. However, since the Commission issued its order approving the Settlement and its July 12 Order approving Alliance RTO's scope, the confidence of the Commission and participating state commissions in the IRCA's ability to resolve seams issues has eroded. Specifically, as discussed below, the Midwest ISO and alliance Companies filed status reports which indicated that the IRCA implementation has not progressed as expected.
>
> The status reports indicate that certain provisions of the IRCA have not been fully satisfied. More importantly, regarding those provisions that have been addressed, significant seams issues still exist. For example, the Settlement requires the parties to support the development of a standardized process to determine Available Transmission Capability ("ATC") within the region. However, the Midwest ISO and Alliance Companies each state that they will calculate ATC and Total Transmission Capability ("TTC") using similar, but not identical, methods. Failure to use identical methods creates a seam that inhibits efficient market operations. The Settlement also requires that the Midwest ISO and Alliance Companies facilitate one-stop shopping for transmission service. Detailed operating protocols and procedures necessary to accomplish this one-stop shopping have not yet been developed and agreed upon, however. In addition, the Settlement requires that the proposed RTOs cooperate in developing their imbalance markets to ensure compatibility for multi-RTO transactions. The Midwest ISO and the Alliance RTO have only developed compatible, and not common, energy imbalance markets. Moreover, the status reports indicate that both the Midwest ISO and the Alliance RTO will have separate security coordinators. This presents the potential for disputes over security matters on the respective grids—disputes which would not exits if the two systems involved operated under the authority of a single security coordinator.[17]

The Commission's findings clearly demonstrate that the failure to standardize the RTO transmission tariff and related energy markets has created an unworkable process which will leave incumbent utilities with the ability to favor their own generation by

---

[15] *Id.* at P 98.
[16] *Alliance Companies, et al.*, 97 FERC ¶61,327.

discriminating against competitors in neighboring RTOs.[18] Such discrimination results, in part, from creating and maintaining seams which act as barriers to entry. Michigan spent two years attempting to resolve seams issues with incumbent utilities that lacked independence from generation interests. The process does not work and cannot be relied upon to eliminate discrimination against entry and preference for incumbent generators.

A. SPECIFIC INSTANCES OF UNDUE DISCRIMINATION AND IMPEDIMENTS TO COMPETITION

The Commission has clearly identified numerous instances of undue discrimination which must be corrected pursuant to Section 206 of the Federal Power Act.

1. Load Growth

Under the current *pro forma* tariff, transmission providers are able to utilize their transmission system to serve the full requirements of their native load customers. There are no limits on the amount of capacity available to serve bundled retail customers. As

---

[17] *Id.* at 62,529-530.
[18] *Id*.

capacity becomes constrained, the transmission providers have preferential capacity rights to serve native load customers. The end result is unduly discriminatory towards unbundled retail customers and entities that serve such customers.

2. Other Evidence of Discrimination

The Commission has identified numerous instances of discrimination exercised by transmission providers that are vertically integrated utilities. For example, such utilities have a scheduling advantage to the extent that bundled retail load is served without complying with the nomination and scheduling provisions of the tariff.[19] Similarly, vertically integrated utilities have an undue advantage for resolving energy imbalances occurring in the provision of service to bundled retail loads because of their unrestricted access to system balancing. All other customers are required to pay for imbalance services and risk incurring penalties for imbalances that exceed tolerance levels set forth in the tariff.[20]

One of the more disturbing trends is the dispatching of generation by transmission providers to serve their own load in a way that requires other customers to experience transmission curtailments. The fact that the incidence of Transmission Loading Relief ("TLR") procedures by the Midwest ISO increased by 472 percent from the summer of 1999 to the summer of 2000 is clear evidence of a problem in need of a solution.[21]

---

[19] NOPR at P 45.
[20] *Id.* at P 48.
[21] *Id.* at P 58, *n* 48.

IV. THE PROPOSED REMEDY

A. THE INTERIM TARIFF

The Commission's first step towards remedying undue discrimination is to require that all transmission service, including the transmission component of bundled retail service, be provided under the Interim Tariff. This requirement does not directly affect the Midwest because bundled retail load within the Midwest ISO footprint is already required to be served under the Midwest ISO Tariff. [22]

B. INDEPENDENT TRANSMISSION AND MARKETS

1. Independent Transmission Provider

The Commission has concluded there is a lack of independence of the transmission provider in many regions of the country.[23] Fortunately, this is no longer the situation in the Midwest. Michigan, however, can attest to the fact that corporate ties between generation and transmission within public utilities allow vertically integrated utilities to exercise market power to advantage their affiliated generation. To resolve this type of discrimination in Michigan, legislative retail competition initiatives and Michigan-approved settlements require incumbent utilities to provide open access transmission and distribution service to retail customers. To ensure that the incumbent utilities could not use their control of transmission facilities to favor their own generation, Michigan utilities were encouraged to divest their transmission assets from generation.

As a result, Detroit Edison has spun down its transmission assets to a separate subsidiary, International Transmission Company ("International"), which it is committed

[22] *Opinion and Order Affirming in Part and Clarifying in Part Initial Decision.,* 97 FERC ¶ 61,033 ("Opinion No. 453").
[23] NOPR at P 124.

to selling.[24] Similarly, Consumers Energy Company has spun off its transmission assets to Trans-Elect, which is completely independent of any company owning generation assets.[25]

Independently owned transmission companies without any financial interest in generation are the optimum solution for eliminating discrimination flowing from a vertically integrated company. For example, it was no coincidence that, shortly after being sold to an independent company, Trans-Elect withdrew from the Alliance RTO and joined the Midwest RTO.

The Commission proposes to address the lack of independence of transmission providers by requiring that transmission service be provided by an independent entity. All public utilities that own, control or operate transmission facilities will be required to turn over the operation of their transmission facilities to an RTO that meets the definition of an Independent Transmission Provider ("ITP"), or contract with an entity that meets the definition of an ITP.

An ITP is defined as any public utility that owns, controls, or operates facilities used for transmission of electricity in interstate commerce that administers the day-ahead and real time energy markets in connection with its provision of transmission service pursuant to the SMD Tariff, and that is independent (*i.e.* has no financial interest in any market participant in the region in which it provides transmission service).

---

[24] *See International Transmission Company*, 97 FERC ¶ 61,330 (2001).
[25] *See Trans-Elect*, 98 FERC ¶ 61,142 (2002).

The availability of a waiver from the ITP requirement for companies belonging to an RTO implies that the ITP requirement affects only those regions of the country not covered by an approved RTO. In this respect, Michigan assumes that the new requirement to turn over transmission operations to an ITP does not affect Michigan utilities to the extent they are already ITCs <u>and</u> belong to the Midwest ISO. Nevertheless, Michigan supports the ITP requirement as a necessary interim provision to prevent vertically integrated utilities from using their control of transmission facilities to favor their generation affiliates.

2. Role of Independent Transmission Companies in SMD

The Commission seeks comments on the functions that an ITC should perform under SMD. Specifically, the Commission queries whether it should retain the same delegation of functions that was approved in *TRANSLink,* 99 FERC ¶ 61,106 (2002), or are there elements of the proposed SMD that would justify a different delegation of functions? In addition, the Commission seeks comment on whether an ITC should qualify as an ITP.

Michigan is concerned that the Commission has revisited the alignment of functions between the RTO and the ITCs and is gravely concerned with the proposal in the SMD to allow ITCs to serve as ITPs, a concept Michigan vigorously opposes. The same care used by the Commission to delineate the responsibilities between the RTOs and utility affiliated transmission owners should be used with ITCs. Decisions affecting regional electricity transmission must foster open access and the development of competitive energy markets and cannot be left to ITCs. Therefore, the Commission should carefully designate the functional split of responsibilities between the RTOs and the ITCs in all regions, but especially the Midwest ISO/PJM super region.

For example, functions such as regional transmission system planning and expansion must be performed by the RTO in the context of the approved RTO governance scheme. In addition, expansion decisions that impact the region must involve the participation of all stakeholders, including customers and demand side providers, and not just the investors and managers of the ITC. Planning and expansion within an ITC's footprint may, for practical reasons, remain in the domain of the ITC's management. However, transmission planning, siting and certification remain under the jurisdiction of the states, perhaps supplemented by the creation of the MSEs envisioned by the National Governors Association. Additionally, the RTO should be required to operate the energy (balancing), transmission, and ancillary service markets as well as perform congestion management functions. Finally, dispatch and market functions must remain with the RTO, not with a for-profit ITC operating within an RTO.

The Commission should also consider the enormous effort by state regulators, other stakeholders, utilities, and other transmission entities to establish the Midwest ISO. Most stakeholders are comfortable with the independence of the MISO and the decision-making process established therein. This is not the time to abandon this process in favor of a new subset of ITC functions that will erode the ability of the RTO to provide the consistency and transparency of decision-making so crucial to the endeavor at hand. Michigan recommends that an ITC not be allowed to provide any independent functions or anything outside of the ITC footprint, such as loop flow management. This is clearly an RTO responsibility. Furthermore, within the ITC footprint, the maximum set of functions provided by an ITC should not exceed those allowed in TRANSLink. Increasing the ITC's functions will only increase the likelihood of creating additional "seams" within the RTO. This is precisely what those in the Midwest have been trying to avoid. Accordingly, when determining the functional split of responsibilities between an RTO and an ITC, the Commission should err on the side of caution and leave the function with the RTO.

Michigan agrees that ITCs could play an important role in the development of robust competitive wholesale markets. As discussed above, most of the transmission facilities in Michigan are owned by two ITCs, Trans-Elect and International. As for-profit transmission companies, profit incentives should drive ITCs to build, maintain, and operate a reliable and economical grid. Those incentives would also encourage ITCs to aggressively pursue transmission solutions to address customer needs. While such companies should become critical components of the competitive wholesale market structure, they must not be granted special status that would favor transmission solutions over other competitive alternatives - namely generation and demand side response. The functions delegated to Trans-Elect and International are limited to reliability and system planning subject to RTO oversight and approval.[26] While the Commission left the door open for International to seek its own rate design within the International footprint, it is difficult to envision how such a rate design could co-exist with SMD.

Robust competitive wholesale markets must be open to those solutions that best serve the needs of electricity customers. In the final analysis, market success will be determined by how well customer needs are met, not by how much power flows through the grid. Thus, permitting ITCs to serve as ITPs would be a tragic mistake. ITCs must be appropriately viewed as one of many stakeholders interested in meeting customer needs for electricity in regional wholesale markets. ITCs are not impartial participants and should not perform the duties expected of an ITP. Doing so would fatally compromise the objectivity of an ITP that is vital to managing the interests of a competitive wholesale market. Finally, and as discussed above, the Commission, should carefully determine which functions an ITP assigns to an ITC. Such assignment should only involve functions that do not compromise the interests of other competitors, especially demand-side options that the Commission has appropriately identified as underdeveloped at this time. Finally, as previously stated, under no circumstances should ITCs be permitted to serve as an ITP. The Commission's proposal to consider this should be rejected outright as a bad idea that threatens to undermine the entire SMD effort.

C. THE NEW TRANSMISSION SERVICE (NON-PRICING)

1. Network Access Service

The foundation of SMD is the Commission proposal to put all transmission customers on an equal footing by replacing network integration service and point to point service with network access service. Network access service allows all transmission customers flexible use of the transmission system by identifying multiple receipt and delivery points for energy in the day-ahead market. It proposes to treat transmission customers equally by requiring load serving entities to utilize network access service to serve their bundled retail customers. One of the impediments to the development of competitive markets that has occurred in Michigan is the denial of equal access to the State's transmission grid. Inhibiting electricity competition through use of transmission can take many forms, many of which the Commission has identified in the SMD NOPR. A significant advantage incumbent utilities exercise is preferential firm transmission

[26] *See TRANSLink*, 99 FERC ¶ 61,106.

rights and non-tariffed access to serve their retail load, leaving only secondary firm or non-firm transmission options available to potential competitors. Requiring all load to be served under the network access tariff should eliminate any transmission-related advantage accruing to incumbent utilities serving bundled retail customers. Michigan supports this proposal as an important step in promoting nondiscriminatory access to the nation's transmission grid.

The State of Michigan is committed to encouraging the development of competitive electricity markets within the State because competitive markets will provide customers with a wider variety of services that more closely and efficiently match their needs than traditional bundled services. The new network access service, coupled with the pricing proposals adopted by the SMD, will help meet these objectives by placing all transmission users on an equal footing.

2. Bilateral Contracts v. Network Access

The SMD indicates that those customers taking long-term firm point-to-point transmission service will not be required to relinquish that service, at least not initially. This exception is fair as long as it is intended to give those customers time to adjust to the SMD market design and make necessary arrangements to begin taking network access service. However, Michigan encourages the Commission to convert these customers to network access service as soon as practicable. The opportunity to have all transmission customers served by one network access service offers a unique opportunity to promote non-discriminatory open access and, thereby, place all transmission customers on an equal footing.

3. Incorporating Bundled Customers Under Network Access Service

The SMD will help prevent incumbent utilities from "hoarding" available transmission capacity and from indirectly foreclosing efficient use of the grid by implying future available capacity will be dedicated to the incumbents' retail loads. The use of network access service along with the independence of the transmission provider will allow all transmission users the right to schedule transmission flexibly in the day-ahead market. As a result that market will be administered on a non-discriminatory basis. For retail access states like Michigan, one important impediment to direct access – reliable transmission service – will no longer undermine the State's efforts at promoting electric choice programs.

D. Transmission Pricing

There are four major SMD pricing components that Michigan will address in these comments. First, the embedded fixed costs will be recovered from loads within each transmission owner's service area. Second, pricing expansion of the grid must balance network and individual interests in a manner that promotes transmission development. Third, congestion charges will be assessed at points where transmission capacity becomes constrained. Fourth, ancillary services, including losses, will be assessed to transmission customers and will be available through day-ahead and real time markets administered by the ITP.

Generally, Michigan supports the Commission's pricing methodology and will submit preliminary comments as set forth below with more detailed comments to come in January.

1. Recovery of Embedded Costs

The SMD proposes to recover transmission provider revenue requirements only from the loads taking power from the transmission system within the provider's service territory. All other transmission services, including through-and-out transactions and transactions between marketers and load serving entities, will pay only variable charges, including losses. This proposed rate structure offers simplicity and achieves the goal of eliminating pancaked rates. Because pancaked rates are one of the major impediments to economically efficient use of the transmission grid, pricing provisions that contribute to the elimination of rate pancaking represent a major step forward in encouraging the efficient use of the nation's transmission grid. The proposal to limit fixed cost recovery from loads taking power off the system also allows each transmission provider the opportunity to recover its revenue requirement. Moreover, any attempt to systematically or repeatedly over-recover transmission revenue requirements would be much more difficult and transparent than under the current OATT. There are three issues, however, related to recovery of embedded costs that Michigan believes merit further development.

2. Rates for Bundled Retail Customers

The Commission seeks comment on whether bundled and unbundled retail load should be charged the same rate. Michigan supports requiring all load, including grandfathered wholesale and bundled retail transactions, to take service under the Network Access Tariff. Such requirement is necessary to ensure that bundled retail load is not provided preferential rights to transmission capacity over unbundled retail load.

It is less clear whether it is necessary that bundled retail sales be charged the same rate as unbundled sales. Currently, bundled states regulate the price of transmission as part of the bundled generation and distribution components of retail sales. Allowing such states to continue such price regulation may not have a significant impact on competitive markets in neighboring states which have unbundled retail sales. Michigan, nevertheless, supports a policy that requires all load to pay the same rates for the transmission component of service because doing so places all sellers and all buyers on an equal footing. Moreover, requiring the transmission component of bundled retail sales to be provided at the Commission-approved rates does not interfere with the bundled states' jurisdictions to continue regulating such sales on a bundled basis.

3. Inter-regional Transfers

In order to facilitate competition, the Commission proposes to eliminate rate pancaking and make consistent rate treatment for intra- and inter-regional transactions. Under the Commission's proposal, an export and through-and-out transaction originating in one ITP's system and terminating at load in another ITP's system would pay only the access charge for the transmission system where the load is located (the "sink").

The Commission has indicated that some utilities, like AEP and Cinergy, experience such a large volume of through-and-out transmission transactions that charging embedded costs to load serving entities within each transmission owner's area raises an issue of cost shifting from customers in the sink area to customers in the source area. Michigan recognizes, that, like parallel flow, these transactions may cause costs on one system that benefit another. To address this cost shifting, the Commission has suggested two remedies:

(1) Have the "source" ITP allocate a portion of its revenue requirement to the "sink" ITP's transmission customers. An ITP's revenue requirement could be reduced by the amount of through-and-out service and that amount of the revenue requirement would be included as uplift in the scheduling charge paid by all customers of the sink ITP. The Commission

recognized that this method would require a projection of inter-regional transfers, a rate filing to accomplish the re-allocation of costs between ITPs, and a decision as to how to narrowly focus the cost allocation.

(2) Adopt a revenue crediting approach, whereby inter-regional transfers could be priced at the load ratio share or similar charge, and the inter-regional transaction charges would be netted out over a specific time period. The inter-regional charges would be charged to customers in the sink ITP's service area, and the cost of transmission on a neighboring ITP associated with imported power could be charged to all of the net importing ITP's customers through the scheduling charge. Revenues would be returned to all transmission customers with the net exporting ITP.

At this time, Michigan has not taken a position on which of these remedies may be most appropriate. Michigan, however, does have some preliminary views on the scope of recovery of any such charges. The more narrow the recovery of embedded transmission costs for through-and-out service, the more concentrated the short-run marginal cost of the transaction. However, the broader the recovery, the more it may contribute to congestion and reliability issues. The problem of allocating through and out charges as a broad-based uplift charge is that it socializes cost. While it encourages more intensive use of the transmission system, thereby improving efficiency in the short-term markets, it also contributes to growing congestion and future reliability issues. In considering these two effects, Michigan favors allocating costs resulting from the transaction to those receiving the benefit. To achieve this objective, Michigan suggests focusing on payment and recovery on a zonal basis within each transmission provider's area.

Michigan also suggests establishing a threshold for levying embedded transmission costs on through-and-out transactions. Specifically, charges for occasional, or non-recurring transactions could be waived. Where transactions are "common", in that they form an integral part of a trading pattern, or are contractual, such an assignment of cost would be more appropriate. These "longer-term" transactions are more likely to contribute to chronic congestion or reliability issues and, therefore, it may be more appropriate to make a revenue recovery allocation to these customers. In either case, it is appropriate to provide CRRs to those customers who contribute to the recovery of embedded costs of a transmission system, including those in a neighboring RTO.

4. Application of Inter-regional pricing to parallel path flows

MISO's revenue distribution methodology explicitly recognizes the adverse impact that parallel flows can have on a transmission owner. The effects of parallel flows can have the same financial impact as through and out transmission transactions and can materially degrade the reliability of transmission components, thereby raising costs for the actual path provider. MISO's methodology allocates revenue based on both contract path and on actual flows. The SMD has many provisions that assign costs to those market participants that cause the costs, for example using locational marginal costs as the basis for a transmission usage charge. The SMD offers an opportunity for the Commission to extend the concept of cost causation to that of parallel flows. Michigan encourages the Commission to require all ITPs to recognize parallel flows and devise pricing methods or revenue distribution methodologies that allocate embedded transmission cost and any resulting congestion costs to the parties causing the flow.

5. International Border Considerations

Michigan urges FERC in the development of the SMD to be mindful of international border considerations. For Border States like Michigan, longstanding trading relationships established with our valued Canadian neighbors are vital to our mutual well-being. This is especially true with respect to electric energy, where the

Ontario/Michigan interface, with a rated capacity of 2400 MW, has greatly benefited both parties. Over the years substantial amounts of energy have been exchanged, and reliability for both Michigan and Ontario has been significantly enhanced. Michigan strongly appeals to FERC through the SMD to recognize the importance of this relationship and provide great deference to preserving and strengthening it. The importance of this concern to our State's well being cannot be overemphasized. Ultimately, Michigan is more affected by how the SMD impacts this relationship than decisions involving many other parts of the NOPR.

As long as transmission lines traverse jurisdictional boundaries, electrons, governed by the law of physics, in manner of speaking, will follow the path of least resistance, and customers, responding to the principles of economics, will demand competitively priced, reliable electricity, regardless of where that energy is produced. Alternatively stated, electrons and the customers who consume them are largely indifferent to facility ownership or location. Likewise, rate pancaking, reliability, seams issues, and loop flow concerns do not stop at the border. FERC in opening up the SMD to comments from all interested stakeholders apparently is cognizant of this fundamental relationship.

Michigan applauds FERC for inviting our international partners and friends from Canada to comment on the SMD NOPR. Michigan urges the Commission to give great deference to their issues and concerns. Michigan values our electric energy relationship with Ontario and place it on par with that of any other trading partner in this country. To the maximum extent possible, Michigan supports FERC SMD decisions that welcome and support the full participation of Canadian interests in our wholesale market structure.

Since the Province of Ontario is restructuring its wholesale markets, much along the lines suggested in the FERC SMD NOPR, the opportunity for mutually beneficial cooperation to bring the markets in line and strengthen our trading relationship is certainly timely. Regional planning, in particular transmission infrastructure development and resource adequacy considerations, should involve strong international cooperation and, were possible, joint decision making wherever significant trading relationships exist, such as those between Michigan and Ontario.

6. Pricing of New Transmission Capacity

As a guiding principle for transmission pricing, Michigan generally supports assignment of costs to those receiving benefits. However, Michigan does not support exclusive reliance upon participant-based funding for transmission expansion cost allocation because there is a need for both rolled-in pricing and participant-based pricing. The appropriate methodology should be dictated by the circumstances presented on a case-by-case basis. If beneficiaries can be clearly identified and benefits and costs accurately quantified and appropriately assigned, participant-based pricing should be relied upon for cost assignment. Such an approach is in keeping with the overall efficiency objectives in the SMD and should be supported as the preferred means to send proper pricing signals. However, rarely are benefits and costs totally separable and readily assignable. Many transmission expansion decisions provide system-wide benefits as well as benefits to an individual customer or group of customers. Thus, some portion of most transmission expansion projects is likely to be best assigned to system users at large through rolled-in pricing.

Transmission infrastructure development is an important item in the SMD. Michigan agrees that the current transmission system is underdeveloped and needs considerable investment to serve more efficiently existing and rapidly expanding wholesale electric energy demand; however, those involved in restructuring the nation's wholesale electricity markets differ on how to accomplish this needed investment. Michigan is concerned that the debate over rolled-in vs. participant-based transmission pricing has become polarized along theoretical lines; however, it need not be viewed in that context because there is a place for both methodologies. Where benefits can be readily identified and costs properly assigned, they should be allocated accordingly; where that is not the case, rolled-in pricing should be applied. The ITPs, with guidance from the appropriate stakeholder and advisory groups, should be charged with sorting out these important allocation decisions on a regional level. Some regional variation may be expected to mirror differences in regional trading patterns, power flows, and appropriate benefit/cost allocation. Once the Commission establishes the overall direction guiding transmission cost allocation, application will be implemented regionally, reflecting the varying circumstances present or emerging across the country. At the end of the day, support for efficiency-driven transmission expansion through reliance upon benefits-based pricing need not overrule commons sense decision-making. Some transmission expansions generate benefits that are system-wide in scope or are simply not divisible among customers and should be socialized through rolled-in pricing. To suggest otherwise is akin to sticking your head in the sand. Michigan does not think that is what the Commission has in mind. Michigan's support for participant-based funding is intended for guidance purpose only. It is not intended as an ironclad rule.

E. THE NEW CONGESTION MANAGEMENT SYSTEM

1. LMP

Michigan supports the Commission's move to Locational Marginal Pricing ("LMP") as the primary method of managing congestion and allocating capacity on the nation's transmission grid. The proposed congestion management system encourages economic efficiency, allocates scarce transmission resources to those that value them the most, addresses transmission reliability issues, promotes flexibility in designing and arranging energy and transmission transactions, and supports Michigan's efforts at promoting retail electricity competition within Michigan. Finally, the proposed congestion management system will work effectively for spot and bilateral markets, both of which are essential to a healthy competitive electricity market.

A standard set of rules allows the competitive market to function better. The LMP method has been tested and used for managing congestion in the PJM and New York markets. The LMP method is based on the fundamental concept of marginal cost pricing and relies on economic redispatch to manage congestion. By relying on market based pricing when transmission capacity is constrained, the SMD will allocate capacity to those who value it most. At the same time, those transmission customers wishing to complete a transaction, even when lines are congested, will be able to do so as long as they are willing to pay the market price. Congestion is managed through energy prices and transmission charges determined in a bid base market, which protects customers from the exercise of market power.

Michigan supports bilateral contracts as the primary base for load serving entities meeting their load requirements. Transmission usage charges for bilateral transactions are based on the difference in spot energy prices and therefore would not bias a customer’s choice between purchasing energy through the spot market versus a bilateral transaction.

Two features of the SMD, which Michigan strongly supports, should protect retail customers from the potential price volatility in this market. First, CRRs will be allocated to those customers paying the embedded costs of the transmission system. This should offer these customers protection from congestion costs. Second, the Commission's commitment to an effective market monitoring process assures that market participants will not manipulate prices and disrupt the market. Both of these features, working effectively, are essential components to an efficient locational marginal pricing system.

2. Congestion Revenue Rights

Possession of CRRs will assure those paying the embedded cost of the transmission system that their transmission costs will not increase in the presence of actual congestion. This gives transmission customers price certainty in the day-ahead markets. Plans are likely to change because of weather and other factors and can be accommodated in the real time markets. Although the SMD does not offer the opportunity for congestion protection in the real time market, it may be just as likely that changes to the day-ahead schedule would produce savings rather than additional costs. Because changes to the day-ahead schedule are likely to occur, Michigan supports the adoption of a real time market to provide an opportunity to “adjust” the day-ahead schedule.

Michigan stresses that various aspects of the Commission’s SMD proposal, such as tariffs and pricing, must be implemented together to be effective. Each component is important in contributing to a system that functions efficiently. For example, network access service and the day-ahead market schedules must respect the operational constraints on the transmission system. Similarly, a financially binding day-ahead market with adjustments occurring in real time allow for planning and modifications; and CRRs provide assurance that expectations regarding day-ahead planning and costs can be realized. These elements work collectively to promote a nondiscriminatory, economically efficient transmission system in a way that supports the efforts of open access states to provide their ratepayers with a choice of suppliers.

Michigan supports allowing all customers, whether or not they hold CRRs, to schedule transmission. This is in harmony with the Commission's goal of requiring nondiscriminatory access to the transmission grid. The final decision on which transactions may take place in the presence of transmission congestion will be dependent on the relative value that each potential transaction customer places on use of the grid.

Michigan encourages the Commission to direct independent transmission providers to begin auctioning and reconfiguring congestion rights as soon as possible. As patterns of trade change and as load shifts geographically, different generators are utilized. The ephemeral nature of supply and demand requires congestion protection to be as flexible as possible. Flexibility is enhanced by the early introduction of options as well as obligations and flowgate rights. It is also enhanced by allowing these rights to be traded, reconfigured, sold, and bought in a secondary market. Auctioning rights allows new transmission customers to realize the same price protection that existing customers experience. This promotes entry into markets by new suppliers both generating and selling power at retail, where this is permitted, as well as providing price signals for new facility investments.

a. **Allocation of Rights**

Michigan supports initial allocation of CRRs to those customers who pay the embedded cost of the transmission system. This can be accomplished by providing the allocation of CRRs to retail load serving entities to cover their existing requirements and future growth. These rights permit the holder to receive the revenue they pay to access a congested line thereby providing them protection from congestion costs. Michigan also recommends that the rights follow customers in states that choose to permit retail customer choice. If rights do not follow customers, new retail electric suppliers may be at an insurmountable disadvantage relative to incumbent suppliers.

b. **Ancillary Services and Loss Markets**

Nondiscriminatory access to market-priced ancillary services and losses, including access to energy imbalance markets, is an indispensable component of the SMD. Michigan supports the Commission's plan to require ITPs to operate these markets on behalf of transmission customers. Without nondiscriminatory access to these services, competitors to traditional utilities would be at a major disadvantage, especially in areas of the country where most of the generating capacity is owned and operated by traditional, vertically integrated utilities. The existence of these markets, operating fairly and efficiently, will assure market participants that they will have access to necessary services at market based prices.

F. DAY-AHEAD AND REAL-TIME MARKET SERVICES

The Commission's " Strawman" discussion paper on market metrics and market monitoring provides insight on these two issues in the SMD NOPR. Michigan supports the Commission's SMD market design proposals for the reasons stated below.

1. Design of the Day-Ahead Market

Michigan supports having the RTO or the ITP operate the day-ahead energy market and use of a market-based real-time energy market system for resolving energy imbalances. Generation operators and load-serving entities both benefit from the function of a day-ahead energy market. Michigan also supports the use of financial bids to help bring convergence between day-ahead and real-time prices. Michigan, however, questions adoption of hourly bidding at this time. The complexity of introducing hourly bidding contemporaneously with day-ahead bidding may involve taking on too much too soon and warrants further examination. Financially binding day-ahead markets are the better alternative at the outset because they provide time to address market deviations, while avoiding price volatility and the complexity of hourly bidding. Hourly bidding markets could be added at a later date if deemed necessary. Although Michigan sees the potential benefit of hourly markets, mandating that they be a day-one priority may be ill-advised. Michigan questions the need for requiring both day-ahead and hourly markets at the beginning of the SMD rollout.

Transmission customers can submit schedules in the day-ahead market by specifying receipt point, delivery point and megawatts to be transmitted. Load serving entities can implement demand response by submitting bids that will cancel when transmission charges are too high.

The NOPR allows the ITP to schedule all requests for transmission service under the assumption that all users have agreed to pay any applicable congestion charges. Thus, customers with CRRs would receive congestion revenues that help offset any congestion charges paid as part of the transmission usage charge. Michigan generally supports scheduling all requests for transmission. All requests should be scheduled and handled through standard procedures. The proposed concept of allowing transmission customers to submit multi-hour and multi-day schedules, although attractive, may warrant further examination to explore feasibility and appropriate implementation timing. This flexibility may be more effectively introduced after the basic market design features are in place. As previously pointed out in our comments, not everything need be introduced at once. And, it may be problematic to pursue too much at the outset, as the additional complexity and resource diversion from the more immediate and crucial elements may significantly hinder or delay accomplishment of the overall market restructuring goals. This scheduling feature is something that should be explored in the future. However, before implemented there should be evidence that such a concept is feasible and beneficial.

This SMD is a huge undertaking and it is critical that everyone work as a team to carry out responsibilities, including coordination among ITPs when transactions cross borders. Michigan supports the SMD's method of arranging for transmission service across borders through financial options. One-stop shopping for cross-border transactions can be accomplished by offering CRRs to interconnection points common to each ITP. A standard set of procedures for splitting customer's bids for CRRs that cross ITP boundaries must be developed by the ITPs.

When energy is transmitted from a point of receipt to a point of delivery, some line loss occurs. As power is transmitted over greater distances which traverse multiple transmission systems, the percentage of power that is lost varies on each system, depending on the voltage of transmission lines, the load factor and distance of transmission. Michigan supports a methodology for recovering such losses based on the marginal losses caused by each transaction. This method will promote efficient use of the transmission system, as well as more efficient demand response alternatives. It is the method that is being used by MISO. Michigan supports allowing transmission customers the option of paying for losses by cash or by self-provision.

a. <u>Day-Ahead Energy Market</u>

Michigan agrees that the ITP or RTO should be required to run a voluntary, bid-based, security-constrained day-ahead energy market. The day-ahead energy market is a complement to bilateral transactions that allow generators to make efficient off-system purchases and sales of energy. Standardized forms for submitting bids to buy and sell energy in the day-ahead market should be designed for both submitting price-responsive as well as price-taking bids. The bids should specify whether they are physical or purely financial. In order to mitigate the exercise of market power, Michigan supports the need to set limits on bids. Suppliers should be allowed to submit bids in the day-ahead market that specify the amount of energy available or the number of hours available for production over the next day. The features outlined above maximize payment to suppliers and minimize costs to load.

Michigan supports the use of hourly LMPs to establish the costs for transmission usage and settlements in the day-ahead energy markets. Trading hubs for natural gas have worked well and Michigan supports the establishment of trading hubs to be used for financial energy transactions. Bids accepted in the day-ahead energy market assure that the fixed charges associated with start-up and no-load bids will be paid and Michigan supports allowing generators to bid start-up and no-load fixed charges on a daily basis. The prompt settlement of market transactions and posting of market prices, as well as requiring the day-ahead energy markets to be financially binding, makes for an efficient competitive market and supplies market participants their transactions promptly.

The ITP will use the day-ahead market to develop prices and a schedule for suppliers. The ITP should ensure there will be sufficient capacity to meet the load by committing sufficient generation to the day-ahead market. Replacement reserves should be procured by minimizing the cost of availability. Generators selected to provide replacement reserves should, if run, be paid real-time prices, and not less than their bids for availability, start-up, no-load and energy. Revenue short-falls would be recovered pro rata from all loads that buy energy in the real- time market.

b. Day-Ahead Ancillary Service Market

Michigan supports day-ahead and real-time markets for energy and for all four ancillary services. This allocation of generation maximizes value to market participants and yields consistent prices among the various products. Michigan supports requiring full bid information for ancillary services and the ITP establishing the market clearing prices for all of the ancillary services. Michigan is concerned, however, that allocating day-ahead capacity costs for ancillary services on a real-time load-ratio share basis could provide more opportunity for generators to engage in gaming by playing off the day-ahead energy market and regulation markets. Thus, the benefits of day-ahead ancillary services may not out-weigh the potential cost to customers. This examination warrants further examination.

Exports should not be charged for ancillary services because the load being served by the export will pay for ancillary services. If the generator also paid for the exports, there would be a double recovery of such charges. The costs of ancillary service should not be allocated to customers that are self-providing those services.

2. Design of the Real-Time Markets

Standard time lines for allowing load serving entities the opportunity to make changes to their day-ahead schedules prior to real-time is reasonable, but real-time rather than ex post day-ahead prices to such changes made in day-ahead schedules should be applied. Michigan therefore supports the concept of bids for incremental and decremental energy from the day-ahead schedules. Because there will be departures from day-ahead due to variety of factors, Michigan supports the ITP balancing supply and demand in real time through the use of market clearing prices. Michigan expects a short turn-around in time to change prices during times of imbalances.

a. ***Ex Ante* v. *Ex Post* Pricing**

The SMD could operate satisfactorily under either *ex ante* or an *ex post* pricing system for settlement of energy and imbalances. Both systems have their advantages and disadvantages. Michigan is satisfied that the Commission's proposed *ex post* method is reasonable and should work well, as it has for the PJM market. Michigan opposes adding artificial charges for market participants appearing to deviate slightly from their bids.

b. **Real-Time Ancillary Services Markets**

Michigan supports the concept that increased costs of regulation service for ancillary services be allocated to entities that had uninstructed deviations from their schedules. Generators should be fairly compensated for their incremental costs in situations where the ITP requires additional reactive supply. Regulation and frequency response service should be charged to generators and loads based on deviations from schedules that are in the opposite direction to that required by the system. This mechanism will provide the most efficient mechanism for interconnection frequency control and negates the need to set up separate mechanisms for generators.

c. Imbalances/penalties for failure to deliver

Michigan supports investigation of situations that force a generation unit off line, but not automatic penalties for all outages. Penalties or fines should be assessed if the outage was within the control of the participant. Penalties should be consistent and should not be scaled to the size of the participant.

3. Market Rules for Shortages and Emergencies

Standard procedures that suspend market rules must be in place in order to maintain reliability of the power grid. There is a need to include procedures for the curtailment of transactions and/or load in situations where the financial (LMP pricing) system has failed to eliminate sufficient transactions. The ITP and RTO should have authority to take such actions as necessary to maintain grid reliability.

G. MARKET POWER MITIGATION AND MARKET MONITORING

Effective market monitoring and market power mitigation are critical elements to the SMD and it is essential to the public interest that the Commission adopt comprehensive rules to secure effective oversight and market mitigation. It is also very important that market mitigation plans be relatively consistent across the states.

Michigan's comments are focused on the need to assure adequate authority, scope and independence of these functions.[27]

The objective of the market power mitigation measures is to provide the means to mitigate the market effects of all conduct that would substantially distort competitive outcomes, while avoiding unnecessary interference with competitive price signals. Such mitigation procedures must be included for all participants and are intended to minimize interference with open and competitive markets. Mitigation measures are designed to mitigate specific conduct only when the conduct exceeds well-defined conduct thresholds and when the effect on market outcomes of the conduct exceeds well-defined market impact thresholds. The mitigation procedures should be designed to allow prices to rise efficiently to reflect legitimate supply shortgages while effectively mitigating inflated prices associated with artificial supply shortgages in transmission constrained areas resulting from physical or economic withholding.

Market power is defined in the NOPR as "the ability to raise price above the competitive level." The Commission notes two structural flaws impeding the development of a structurally competitive market: lack of price-responsive demand on the demand side and generation concentration in transmission constrained load pockets on the supply side. The Commission proposes new market power mitigation measures to

[27] Michigan also notes its support for the "Strawman" in the Commission's Staff discussion paper on Market Metrics and market monitoring of October 2, 2002. As demonstrated by the Commission Staff, it is important to adopt a standard set of market metrics as we move toward a standard set of design elements under SMD. Michigan has confidence that the Commission Staff has the ability to identify market power and utilize the appropriate measurement tools to make such assessments.

address the defects in wholesale electric markets and proposes that the ITP operate the spot markets.

Michigan agrees that free functioning markets can be and often are useful tools in improving economic efficiency and reliability. However, in practice, as history – including recent events – has taught us, undue reliance on markets with limited or no oversight can create as many problems as are sought to be solved. Industries, such as electricity, that have been heavily regulated over a long period of time are especially vulnerable as they transition toward deregulation. Additionally, successful introduction of competition is especially challenging in the electric industry due to vertical integration. The discussion in the NOPR of the trading and financial scandals that have cost consumers and market participants billions of dollars demonstrates that misplaced faith in the abstract concept of the free market is no substitute for flexibility and good sense. The markets envisioned by the Commission may not always function properly and can cease to be effective in maintaining rates at just and reasonable levels. Even workably competitive markets can have localized constraints that allow suppliers to exercise market power. Therefore, it is appropriate and necessary for the Commission to emphasize proper market design and market structure while also adopting strong measures for monitoring the markets and mitigating the incidence of market abuses.

1. Overview of the Market Power Mitigation Measures

The market power mitigation measures proposed in the SMD are primarily intended to mitigate market power in spot markets operated by the ITP. The ITP would be obligated to identify load pockets or other conditions that create local market power. The Commission proposes three mandatory components and one voluntary component in its mitigation plan. The first measure is directed at the local market power problem. The market monitor will identify the conditions wherein certain generators are located in concentrated geographic markets due to transmission congestion or the grid's reliability needs. Under those conditions and when they are under a must-offer obligation, those units will have their bids capped. The second component is a safety-net bid cap that redresses the lack of price-responsive demand. The third component is the resource adequacy requirement. The resource adequacy requirement expands resource alternatives inhibiting the ability of suppliers to practice physical or economic withholding. The fourth and voluntary component is used in situations where non-competitive conditions may exist and is similar to an automated mitigation procedure ("AMP").

Michigan recognizes the importance of market monitoring and has been working with a Market Monitoring Working Group at MISO. That group, under the leadership of Dr. David Patton, has been working on Market Mitigation measures through development of a Market Monitoring Plan. Michigan is pleased with the MISO process and supports the MISO Market Monitoring Plan. It represents a good attempt to balance the various stakeholder interests. The mitigation plan devised in the SMD should not be significantly different across neighboring states or ITPs. Dr. Patton's proposal is consistent with the SMD and the Commission's concern about mitigating market power in load pockets during times of constraints.

2. Local Market Power

Michigan is concerned with the consequences of local market power in load pockets. In fact, the Staff of the Michigan PSC prepared a report on Market Power in Michigan's Upper Peninsula in June 2001. Michigan Public Act 141 of 2000 includes a market concentration test that triggers required mitigation measures by an electric utility that fails the market power test. Thus, the concentration of generation by one owner and the effects of transmission constraints on competition and market power were reviewed for Michigan's Upper Peninsula. Planned new transmission infrastructure expansion should assist in the elimination of load pockets in the Upper Peninsula.

Michigan supports mitigation proposed in the SMD mitigation plan that addresses local market power. Michigan supports the SMD *pro forma* tariff in requiring all generators dispatched by the ITP to be required to enter into participating generator agreements and the filing of such agreements at FERC. In addition to requiring bid caps in the participating generator agreements, Michigan supports bilateral contracts as an effective way for a buyer to mitigate the market power of the seller. Dr. Patton's proposed mitigation plan provides thresholds for identifying physical and economic withholding, as well as uneconomic production and provides mitigation measures. Michigan is generally supportive of Dr. Patton's mitigation plan for addressing local market power concerns in load pockets.

3. The Safety Net Bid Cap

The Commission's three-pronged approach to encourage compliance with the reserve margin requirement is adequate. However, Michigan questions whether a safety-net-bid cap penalty of $1000/MWH for violation of valid curtailment orders will be high enough to insure that reliability will be sustained. Although Michigan is not troubled by setting the initial cap at $1000/MWH, the appropriate level should be considered a work in progress. Experience will be needed to determine the proper level to ensure compliance. Michigan supports a safety-net bid cap that is uniform across an interconnection.

4. Mitigation Trigger Mechanism

At this time Michigan does not see the benefit or the need for a voluntary market power mitigation measure. If it is determined that this measure is needed it can be addressed at a later date by the RTO/ITP and their market monitor.

5. Market Monitoring

a. Framework

Michigan supports a strong market monitor with clearly specified authority to: (1) prevent market participant behavior that would result in manipulation of market prices or otherwise reduce the efficient operation of the market; (2) recommend changes in market design and market structure where flaws exist; (3) apply sanctions and penalties to identified violations of market rules, abusive or disruptive activities; and (4) impose price limits in situations where the market is clearly dysfunctional. Unless these tools are available to the market monitor, there is little hope that the market monitor can protect the integrity of the markets, the individual market participants and the end-use customers. In short, it would be unreasonable or otherwise inconsistent with the public interest for anyone to place unqualified and unguarded trust in the electric wholesale markets established under the SMD in the absence of market oversight and mitigation.

Independence is critical. As explained by the Commission, "market monitoring should be conducted on an on-going basis by a market monitoring unit that is autonomous of the management and all market participants."[28] To achieve this

[28] NOPR at P 433.

objective, the market monitor should be an independent agent that reports to the Commission, but that is not part of the agency. The key is independence from all participants. The requirement that the market monitor report to the Commission will enable the Commission to identify and investigate market power abuses. The Commission, of course, retains the jurisdictional responsibility to investigate market power abuses on its own as necessary. The market monitor would provide a further check and balance.

6. Data Requirements and Data Collection

"To meet its responsibilities, the market monitor must have the ability to collect and evaluate all necessary data provided by the Independent Transmission Provider and market participants."[29] The availability of information or data is critical to the market monitor. The Commission should make clear that the market monitor is required to share this information with the RSAC. The Commission should also clarify that such information will also be made available to state regulatory agencies so that each of these regulators will have available all necessary data to properly perform functions in a coordinated manner.

The Commission appropriately has ordered that "as a condition [precedent] for participating in the spot markets and using the transmission grid, market participants must agree to provide the market monitor with any information requested."[30] The Commission must make clear that market participants must provide the market monitor all information that the market monitor and the RSAC deem relevant and in such form

[29] *Id.*
[30] *Id.* at P 449.

and depth as such entities request.[31] The Commission should further clarify that the market monitor should be able to randomly audit computer correspondence (including networks) and the phone records of market participants. The market monitor should pay particularly close attention to those entities that have previously been involved in abusive or disruptive behavior. If the market monitor believes a market participant has engaged in behavior that is disruptive to the market, the monitor must have unrestricted access to any additional information that the market monitor deems to be appropriate under the circumstances.

Many states, especially those that retain authority over generation and power supply, should be enlisted in assisting the Commission and the market monitor to ensure prompt and complete compliance with requests for information. As a matter of course, the states ought to be provided analyses from the market monitor that is relevant to them.

Michigan agrees with the Commission that guidelines for confidential or otherwise sensitive data should be developed and administered by the Commission. Such guidelines should be developed in consultation with the market monitors, states, the Department of Justice ("DOJ"), and the Federal Trade Commission ("FTC") and, where appropriate, other experts. Any confidential information that is available to the market monitor should be made available to state commissions subject to the protections contained in these guidelines. The guidelines for treatment of confidential material must not permit claims of confidentiality to delay timely production of requested information.

[31] The market monitor must have access to information from markets that are not operated by the ITP. For example, it may be possible for gas companies to withhold unused pipeline capacity and drive-up the price of natural gas and, thereby, the price of electricity. The market monitor must have the authority to obtain information from gas suppliers and may require information from market participants on their fuel supply contracts.

In no instance, should a claim of confidentiality be allowed to impede the market monitor's responsibilities. Where the privilege of confidentiality is asserted, the burden of proof must fall on the party asserting the privilege and the Commission should make all final determinations wherever a dispute occurs.

While recognizing that some information should be treated as confidential and proprietary, any information that is obtained by the Commission must be provided to the state commissions subject to the confidentiality procedures within each state and/ or applicable Commission rules or mandates. In some instances, the designation of confidentiality may be removed when the release would no longer reveal information that could be detrimental to the supplier of the information.

a. Reporting Requirements

Michigan endorses the requirement that the market monitor should report directly to the Commission. Michigan also concurs that, the market monitor must also simultaneously report to the RSAC and the state commissions.[32] Unless there are issues of confidentiality, such reports should also be provided simultaneously to the Board of Directors ("BOD") of the ITP. However, to maintain and ensure independence, the market monitor must be able to report to the Commission, the RSAC, individual state commissions, FTC, or the DOJ without prior review or authorization by the ITP's Board of Directors or Management.

---

[32] Regarding the market monitor's authority to report directly to the state commissions without prior review of the ITP's board or management, the market monitor should have an obligation to report on all matters of state concern (such as a situation that has ramifications for a state or a jurisdictional entity), whether these matters have a direct or indirect effect on the states. For example, the market monitor should critique the ramifications of events in the wholesale markets on the retail markets. Copies of the report should be sent simultaneously to the Commission's Office of Market Oversight and Investigation. Where the market monitor deems it to be appropriate, the market monitor may provide copies to the RSAC, the state commissions, the FTC, the DOJ, and the BOD of the ITP.

Michigan concurs that the market monitor reports must start with an initial assessment of market conditions and identification of market power in all markets run by the ITPs and the conduct of individual market participants. Michigan agrees that this function is *critical* to ensuring that the requisite independence is being maintained by the ITP as well as to ensure the proper behavior of the individual market participants.

The market monitor must have authority to review and investigate power transactions in advance of the day-ahead markets to better ensure transparency that is critical to the success of the wholesale market. The Commission indicates its concern that the "over-mitigation" of spot prices may weaken incentives to contract in the bilateral market.[33] This concern must not cause the Commission to stop short of the necessary level of spot market mitigation. The Commission Staff acknowledged this need at a meeting at the Midwest ISO in Carmel, Indiana on September 19, 2002. Michigan agrees with the Commission Staff that it is essential for the market monitor to have authority to review and investigate transactions in advance of day-ahead markets, including transactions at trading hubs or flow-gates if they are incorporated into an ITP's market design.

In the SMD NOPR, the Commission suggests that the market monitor should be able to review the sales and auctions of CRRs for efficiency.[34] Michigan agrees and

[33] NOPR at P 405.
[34] *Id.* at P 433.

believes that a logical extension of this duty is for the market monitor to also ensure that transactions are fair and that the parties do not unfairly withhold CRRs.

It is Michigan's understanding that a group of states (Indiana serving as the lead state) will be providing comments concerning market monitoring. Michigan, for the most part, agrees with the comments provided by those states on market monitoring. Michigan's comments herein incorporate the principle elements of the joint proposal. The most significant issue of departure concerns the proposal to establish a panel of experts to serve as a market monitoring oversight group. Michigan does not support the creation of such a panel. Michigan sees little value relative to the associated cost and the bureaucratic trappings that will surely be associated. Michigan is also concerned that the time and resources required to select a panel will divert much needed attention from the primary task of establishing and implementing the market monitoring functions. Michigan is also fearful that the creation of an oversight panel may compromise the independence of the market monitor. With the Commission, the states, other federal agencies with anti-trust and business practice oversight, RTOs/ITPs and market participants all looking over the market monitor's shoulder, there should be ample outside scrutiny of the market monitor.

b. Development and Enforcement of the Tariff Rules

The market monitor must have the responsibility and duty where necessary, to propose to the Commission, the RSAC and the ITP's Board, changes to the market rules[35] and the ability to suggest mitigation measures, including penalties. The list in Paragraph 455 seems to be a good initial set of behavioral rules and the enforcement provisions beginning with Paragraph 454 are appropriate. However, as the Commission points out, these monitoring and mitigation measures must be supplemented due to the "formative stages"[36] that the markets and market monitoring are currently going through.

In the event that a market participant is found to have violated the rules, the presumptive penalties should include requiring the offending market participant to pay the entire cost of the market monitor's investigation – including legal expenses – so that these costs are not socialized among non-offending market participants.

Further, the Commission should impose stringent "conflict of interest" rules on market monitors to further assure their independence and objectivity. Just as the accounting industry is now requiring firms to separate their audit and consulting functions, the Commission should require a bright line for market monitors as well. Such a rule should explicitly prohibit any organization affiliated with or representing the interests of a market monitor from advising other clients on any matter related to energy markets to avoid even the appearance that such advice might enable the client to manipulate the market design in any market.

The Commission has requested comments on whether the market monitor should also be responsible for monitoring the ITP's operations.[37] In Michigan's view, it is essential, in order to assure that generation, transmission and demand-response are all fairly evaluated, that the market monitor be able to monitor and investigate all aspects of the operations and practices of an ITP, including but not limited to market design, provision of ancillary services, tariffs, scheduling, interconnection practices, and

---

[35] *Id.*
[36] *Id.* at P 436; s*ee also* NOPR at P 211 ("We also recognize that over time there likely will be a need to update the tariff provisions to offer new service options or to *further refine market rules*. The *pro forma* tariff is not intended to be a static document but rather one that will evolve over time and meet the needs of the marketplace." [Emphasis Added]).
[37] NOPR at P 432.

planning practices. Such critique will provide greater assurance that the ITP does not discriminate against any market segment and operates in an economically efficient manner.

H. PRELIMINARY COMMENTS ON LONG-TERM RESOURCE ADEQUACY AND REGIONAL PLANNING

The Commission proposes a generation resource adequacy requirement to be applied on a regional basis to avoid shortages and minimize, if not eliminate, the need for involuntary curtailment. The Commission recognizes that the spot market prices do not provide adequate incentives to promote timely investment in generating capacity necessary to preserve long-term reliability. The Commission further recognizes in the NOPR that most demand today is not able to respond to real-time prices because of insufficient price information, inflexible rate designs, and metering limitations. Therefore, demand-side response is not yet a viable alternative to resource adequacy requirements. Next, the Commission advises that Load-Serving Entities ("LSEs") are likely to underinvest in resources needed for reliability if they can depend on resource development investments of others.

Based on these and other reasons, the Commission decided to propose a long-term resource adequacy requirement in the SMD initiative. The Commission clarifies in the NOPR that its resource adequacy requirement is intended to complement, not replace, existing state programs.

The Commission proposes that each region should determine its own appropriate level of resource adequacy based on its own characteristics, subject to a minimum level of resource adequacy for all regions of 12%. The Commission further proposes that the resource adequacy level should be set by a RSAC and will require the ITP to provide a forum and assistance to the RSAC to establish the appropriate level of resource adequacy for the region.

Michigan is pleased that the Commission has granted more time for interested parties to comment on the long-term resource adequacy and regional planning components of the SMD proposal. Issues associated with resource adequacy and regional planning are among the more challenging and important ones to be addressed if the SMD is to succeed in the establishment of vibrant wholesale electric markets. Additional time to examine these issues is wise and hopefully will foster development of an improved proposal, with the prospects of reaching a successful resolution much enhanced. Because of the importance of long-term resource adequacy to successful implementation of SMD, Michigan is providing preliminary comments on the topic at this time. More detailed comments will likely be submitted on behalf of Michigan in January, in compliance with the Commission final deadline on this topic.

Michigan supports inclusion of a comprehensive strategy to ensure transmission system reliability. Underpinned by the fundamental principle that load and generation must be able to be balanced at all times, such a strategy must be designed to ensure the development of an adequate electric generation, transmission and demand response infrastructure. In other words, both supply and demand must be responsive.

Michigan concurs with the Commission's assessment that sufficient lead time will be required to develop the necessary supporting infrastructure to enable self supply or the bilateral contracting structure to flourish as the principle mode of power exchange between buyers and sellers of electricity. Spot markets, while necessary and vital to energy balancing and for complementing power exchange through bilateral contracting, by themselves will not send the appropriate price signals to ensure long-term reliability. By design, spot markets function as short-term exchanges. Their short-term focus is particularly problematic given the nature of electricity as non-storable and the long lead times often required to develop options to meet customer needs. Generation plant construction (including fuel supply such as natural gas pipelines), transmission expansion, and demand response options can take several years to implement. Plus, lead times for each option may differ greatly. Thus, if bilateral contracting is to comprise the backbone of the system to meet customer electricity needs, a supply system foundation Michigan firmly supports, a strategy for proactively addressing infrastructure development is essential to successful market design. The "straw-man" proposal based upon the resource adequacy proposal the Commission has set forth is a good starting point for moving this vital discussion forward. However, much work lies ahead if the resource adequacy approach is to succeed. Much detail is missing in the SMD proposal that will have to be fleshed out, perhaps over time. Resource adequacy, while essential to the long-term success of SMD, does not need to be fully developed at the outset of SMD implementation. It is an element that could be phased in after the essential SMD components are established and in operation.

Michigan largely supports the Commission in its conclusion that resource adequacy is appropriately addressed at the regional level. Successful SMD will promote expanded trading patterns for electricity. The trend toward nationalization of electricity markets will place ever-increasing pressure for regional planning to address issues and concerns that, like electrons, do not follow state and local jurisdictional boundaries.

Ignoring this fundamental law of physics and its resultant impact on commerce would be short-sighted.

Recognizing the importance of regional planning in the context of SMD is much easier said than done. There is no question that differences among states in reserve margins, resource adequacy requirements, and the existence of retail access programs dramatically affects the ability to create a standard regional resource adequacy requirement. It is not only possible, but necessary, to accommodate these differences and create a resource adequacy requirement for each ITP in consultation with the RSAC. Differing state requirements for resource adequacy and reserve margins can be accommodated. States have been firmly in charge of most aspects of electric energy planning and resource adequacy decisions and are understandably hesitant to part with or share this responsibility. A sound plan, supported by assurance that state interests will be effectively incorporated in the decision-making process through whatever decision making institutions and mechanisms are adopted, will need to be created. Cultivating confidence in regional planning as a superior mechanism to current state planning practices for addressing many planning and resource issues will require considerable time and effort. The MSE proposal of the National Governors Association, although presently limited to transmission planning, siting, and certification, provides for the possibility that states may choose to expand the MSE purview to include other state-jurisdictional issues.

1. Reason for the Requirement

The Commission has properly recognized why a resource adequacy requirement is needed to ensure development of the necessary infrastructure for reliable transmission operations. Investment in electric transmission infrastructure has not kept up with demand. Spot market prices do not provide adequate incentives to promote timely investment in generating capacity needed to ensure long-term reliability. Load serving entities are likely to underinvest in resources needed for reliability if they can depend on resource development investment of others.

It is crucial for the Commission to develop a resource adequacy planning process which addresses each of these problems. Steps need to be taken to promote reliance on demand-side management to maximize the efficiency of the existing infrastructure. States need to work together towards a common resource adequacy requirement, while respecting differences in state laws and retail market structures. Those states that decide to establish a resource adequacy level in excess of any level established for a region should be required to pay for such resources. Similarly, mechanisms need to be developed which compensate those that provide resource adequacy. The overall objective is the development of a resource adequacy plan, which in the aggregate, avoids regional shortages and minimizes, if not eliminates, the need for involuntary curtailment. If this objective is not met, further steps may be necessary to ensure reliability. Most demand is not able to respond to real-time prices because of insufficient price information, inflexible rate designs, and metering limitations.

An effective regional planning process must combine local, regional, national, and international needs in a back-and-forth bottom-up/top-down process within each ITP footprint. The location and baseload, peaking and distributed generation; integrated and stand-alone, profit and nonprofit transmission; and active load management from industrial, commercial, and residential customers must all be considered in the planning process. Public involvement from municipalities, cooperatives, and other planning and siting/development authorities are also essential to the successful implementation of long-term resource adequacy.

Most of these processes already exist and need to be integrated into the ITP's regional plan. There is no need for ITPs to become the central planners of the new millennium, but rather the information integrators and assignors of implementation responsibilities. For example, PJM already uses a pyramid approach to their regional planning process. PJM's process begins with NERC and regional reliability council planning and operating standards that support PJM tariffs and agreements, and then analytical support from resource providers. This foundation supports PJM's regional expansion planning process, the ultimate goal of which is a reliable system. Such an approach could be modified to include input from state authorities and new providers of energy and capacity resources.

Also, many different resources, with varying timeframes in which they need to be brought online, will be necessary to meet the capacity needs of a region. For example, some types of active load management can contribute to capacity relatively quickly, distributed generation may take a little longer, followed by generation plant and transmission expansion. All sources contribute to serving very legitimate and necessary regional needs.

However, it will take unprecedented cooperation and resolve between state and federal regulators, careful observation of and regulatory response to any inappropriate market behavior, and enormous commitment to build and then sustain competitive markets. Current experience in Michigan has seen a drop off in viable competitors, with mostly affiliates of utilities left in the market. If there are fewer sellers, there is less competition. Also, it is possible that during the transition to more competitive markets, there will need to be much more comprehensive market monitoring and market power mitigation to protect customers.

2. Basic Feature of Requirement (Reserve Requirement Approach)

The 12% reserve margin proposed in the SMD is acceptable to Michigan provided that it is considered as a minimum level and is only used as a temporary proxy. The optimal level will vary regionally and should be established by the RTOs/ITPs in cooperation with their respective planning authorities and advisory groups. Historically, as a rule of thumb, Michigan has relied upon a 15% reserve margin above firm load based on a one day in ten years Loss of Load Probability ("LOLP").

a. Demand Forecast

Allocating future resource adequacy needs to forecasted future demand assigns more responsibility to faster growing loads. Allocating future resource adequacy requirements based on the most recently documented load ratio share is more exact. Michigan supports use of the documented load ratio approach.

I. State Participation in RTO Proceedings (Regional State Advisory Committee)

The Commission "is proposing to establish a formal role for state representatives to participate on an ongoing basis in the decision-making process" of RTOs/ITPs.[38] Each RTO/ITP would have a RSAC, the details of which would be determined on a regional basis.[39] The National Governor's Association ("NGA") has proposed MSEs to coordinate transmission planning, siting and certification at a regional level. The Commission sees these as complementary to RSACs. The Commission seeks comment

[38] *Id.* at P 551.

on whether RSACs and MSEs should be combined in some way. It also seeks comment on how state representatives should be selected.[40]

Michigan has been working actively with other states through the NGA and the National Association of Regulatory Utility Commissioners ("NARUC"), as well as with the Department of Energy and others, to help craft a viable model for regional coordination of regulatory activities. Michigan looked closely at the possibility of combining RSACs and MSEs but, notwithstanding the nominal appeal of a single entity, found it to be unworkable. The following description represents the current state of Michigan's thinking, which Michigan is providing as a status report. However, the Commission should be aware that discussions are still underway and a more focused, or even somewhat different, proposal may be available by January 10, 2003, when the next round of comments are due.

There should be one MSE in a region that would coordinate state jurisdictional actions via regional consideration of issues. Regulatory powers would reside with each state and the MSE would be a coordinating body only. Issues to be addressed by MSEs would include transmission planning, siting, and certification as envisioned by the NGA, but could be expanded to include other state jurisdictional topics such as generation planning and siting (at the option of the states in the region).

Each ITP/RTO would have a RSAC to advise it on the Commission jurisdictional issues such as transmission pricing and conditions of service, congestion management, and market monitoring and oversight. Ideally a region would have only one ITP: the

[39] *Id.* at P 552.
[40] *Id.* at P 553.

RTO. The existence of multiple ITPs in a region will necessitate even more complex coordination efforts and should be avoided to the extent possible.

There are a number of key issues relating to RSACs which have yet to be defined including: membership, method of selection, structure and governance, decisional rules, scope of authority, staffing; status of decisions (advisory, deference or final), judicial review and funding. Michigan supports the development of most of these issues by way of regional self-determination. However, state participation in RSACs and MSEs may well be stymied due to the inability to fund expenses, such as travel and lodging, that are necessary to enable effective regional meetings and communication. Michigan proposes that the final rule include a provision for RTOs to reimburse state commissions and other governmental RSAC and MSE members for reasonable expenses incurred to enable participation in RSACs and MSE activities that are related to the RTO.

The Commission expressly requested comment on how the state representatives should be selected (e.g. whether the governor should select them or whether some other process should be used). Each state within an MSE should be represented by an official of the state regulatory authority. The Governor of each state may also appoint a representative to coordinate decision-making among other state agencies concerning issues that are outside the jurisdiction of the state regulatory authority. In sum, Michigan strongly endorses the efforts by the Commission to work with the states on energy infrastructure siting and broader regional planning issues.

J. ITP GOVERNANCE

Independence is the bedrock principle for RTOs. The Commission has recognized the importance of this principle in both Order No. 888 and Order No. 2000. These orders require that the RTO rules of governance should prevent control and appearance of control of decision-making by any class of participants. They did not, however, mandate detailed governance requirements for RTO Boards. Instead, the Commission has reviewed governance proposals on a case-by-case basis. In this respect, the lack of more definitive guidance from the Commission on governance may be hindering the development of larger RTOs. Further, the existing stakeholder process may not provide adequate representation for all market participants. Specifically, the lack of adequate representation may hinder development of critical alternative energy sources, such as distributed generation, renewable energy and demand response programs. To address these concerns, the Commission is proposing to more clearly define the responsibilities of the Board of Directors and the role of stakeholders in the selection of the Board and management of the RTO.

Michigan agrees that more definitive governance requirements will result in greater independence and that the Commission should mandate broader representation of the interests of all classes of stakeholders. In particular, Michigan supports the institution of specific requirements which ensures that that interests of alternative energy sources, such as distributed generation and demand-side response programs, are included among the portfolio of skills represented on the ITP/RTO Board.

1. Responsibilities of the Board of Directors

The Board's primary responsibility is to ensure that the markets are operated in a fair, efficient and non-discriminatory manner. Michigan strongly endorses the Commission's principle that the Board's focus should be on the overall interests of the wholesale market, not in the interests of particular market participants. For this reason, the Board must not be a stakeholder Board with specific seats for various industry segments. However, it is important that the Board understands and appreciates the diversity of interests that are necessary to make the market work effectively. Such an approach is critical both to ensure independence and accountability to the Commission, rather than market participants.

2. Stakeholder Participation

An active stakeholder process is a critical part of the governance of an independent RTO. The Commission has requested comments on whether the current composition of advisory committees may not adequately represent all segments of the industry.

a. Composition

Michigan agrees with the Commission that the current structure of advisory committees is weighted disproportionately towards representation of the functions of a vertically integrated utility (generation, transmission and distribution). The Commission is proposing to address this problem by requiring stakeholder committees to reflect a minimum of six stakeholder classes: (1) generators and marketers; (2) transmission owners (including vertically integrated utilities); (3) transmission dependent utilities, (4) public interest groups; (5) alternate energy providers; and (6) end users and retail energy providers (*i.e.* load serving entities that do not own transmission or distribution assets). In addition, the Commission is proposing a RSAC that would advise the Board.

Michigan supports the Commission's goal of reflecting broader representation of interests in the stakeholder process. Separate representation for both alternative energy and Demand Side Management ("DSM") is essential. Absent such requirement, the classes which collectively represent the functions of a vertically integrated utility are likely to form an alliance against any other faction which is perceived to be a competitor of the traditional electric utility. The Commission should provide for separate representation for both alternative energy providers and demand side management is needed because the inclusion of DSM within the class of alternative energy providers could effectively eviscerate the impact of the DSM interests which compete with all producers of energy, including alternative energy providers. Effective representation of DSM is essential to ensure that the RTO considers all options, including DSM, in planning to meet long term demands of electric consumers.

b. Regional State Committees and Joint Boards

Michigan supports the creation of an RSAC as an entity separate from the stakeholder advisory process. Michigan does not see itself and other state regulators as "stakeholders" with specific constituencies to represent. Rather, state commissions represent a broader public interest and have statutory duties that require balancing the interests of the same stakeholders that are affected by Commission decisions to the extent that they are players in the same region (or areas of overlapping jurisdiction). Therefore, Michigan strongly agrees with, and appreciates, the direction the Commission has been taking to encourage cooperation and coordination between federal and state regulatory bodies. Michigan welcomes the opportunity to work with the Commission and RTO Board on jurisdictional issues through an RSAC.[41] On November 13, 2002, at the NARUC Annual Convention in Chicago, Chairman Wood indicated his willingness to

[41] Michigan assumes that although creation of an RSAC implies that state commissions will be relinquishing a formal voting role in the Stakeholder Advisory Committee, state commissioners and staff will still be welcome to participate in stakeholder discussions and serve on working groups convened under ITP/RTO auspices. Michigan views this interchange as critical to the timely development of workable solutions to the many challenges being faced as a competitive marketplace evolves.

consider the establishment of Joint Boards with State Commissions as provided for under Section 209 of the Federal Power Act. Michigan believes that Joint Boards may well be the most appropriate mechanism for addressing some key issues that need to be addressed as RTOs and regional markets are developed. Therefore, Michigan commends Chairman Wood for his willingness to consider establishment of Joint Boards, urges the other Commissioners to join the Chairman in supporting this concept and commits to working with the Commission to ensure that substance is the primary product of any Joint Board convened, rather than "a happy by-product."

c. <u>Individual Stakeholder Input</u>

The Commission also seeks comment on whether and under what circumstances a stakeholder should be able to take an issue directly to the Board outside the stakeholder process. Michigan supports a liberal approach which encourages an open process under which any minority view may be brought to the Board for its consideration.

3. Initial Selection Process for Board of Directors

The Commission proposes a Board selection process under which a nominating committee engages a search firm to obtain a list of qualified Board candidates. The nominating committee, comprised of two members from each of the stakeholder classes would then review the list and vote for individual Board candidates.

Michigan cannot overstate the importance of promptly electing and empowering an independent Board to oversee not only the RTO/ITP operations, but also the formation and development of an RTO/ITP. The Commission's independence requirements of Order No. 2000 are often viewed by transmission owners as something which must be instituted only after the start-up of the RTO/ITP. The problem with this approach is that the transmission owners remain in control of the decision-making process throughout the formation of the RTO, including the process of developing membership agreements and governing tariffs. Because transmission owners typically are not independent from their generation interests, the end result is a bias to "write the rules" in favor of their own generation. This process leaves the independent Board with the threshold task, upon start-up of the RTO, to eliminate the preferences built in to the RTO structure for certain generation interests. Even for transmission owners without any generation interests, independence is a concern. With a vested interest in transmission, transmission owners are stakeholders in the wholesale electric market and would be expected to favor transmission over other resource alternatives to meet electric demand. This is especially true for competing demand response options.

Michigan suggests that the Commission address the issue by requiring the election of a Board as early as possible in the process of formation of the RTO and to empower such Board with the responsibility to oversee the development of the tariff and other critical documents governing the RTO/ITP.

K. DEMAND SIDE ISSUES

1. Demand Response in SMD

The Commission's SMD NOPR very appropriately strives to elevate demand-responses in electricity markets. Michigan supports the increased emphasis on demand-response and commends the Commission for explicitly incorporating demand-responsiveness into plans for SMD. Michigan agrees with the Commission's observation that, "[w]hen supply and demand do not support fully competitive markets, market design should provide protection against market power."[42] The Commission correctly asserts that there has not been enough emphasis on demand-response thus far in competitive electric markets, and it is appropriate and necessary for SMD to incorporate demand-response as an important mechanism for helping to provide added market competition and to mitigate market power. Michigan further agrees with the Commission that SMD should "encourage long-term efficiency in the development of transmission, generation and demand response infrastructure."[43]

It is appropriate for "market participants to participate in a regional process to identify the most efficient and effective means to maintain reliability and eliminate critical transmission constraints."[44] Michigan supports the development of competitive mechanisms whereby demand responses can effectively participate in electric markets. Michigan further agrees that the appropriate demand response infrastructure is something that should "be determined on a regional basis" and that "supply planning and retail customer demand response are the states' responsibility."[45]

Michigan shares the Commission's observation that, "[T]he ability of customers to bid demand reduction into the spot market in response to supplier prices is still limited and needs to be improved significantly for short-term markets to operate more competitively."[46] Michigan further agrees that "the lack of price-responsive demand" is one of the most significant remaining barriers to competitive markets.[47]

As recognized by the Commission, "[S]mall distributed generation is becoming economic, and some renewable energy resources, especially wind power generation, are also on the verge of becoming competitive."[48] For this reason, it is important that SMD

---

[42] NOPR at P 4.
[43] *Id.* at P 10.
[44] *Id.* at P 12.
[45] *Id.* at P 14.
[46] *Id.* at P 15.
[47] *Id.* at PP 113, 394.
[48] *Id.* at P 91.

make provisions to allow distributed generation to compete in electric markets, both as a potential source of competitive generation services and, where it proves practical and reliable, as another competitive means of providing demand-response service.

While Michigan is aligned philosophically with the Commission on the critical importance of demand-responsiveness in competitive energy markets, Michigan is concerned about the yet-to-be-completed details regarding the implementation of SMD and the importance of such details to the effectiveness of demand responsiveness in our energy markets. As the Commission notes, its "proposed rule does not include detailed business practices and communication protocols that will be needed to administer Standard Market Design."[49] The development and implementation of such practices and protocols will be critically important to the success of SMD. It is imperative for these, and the software that is ultimately developed to support SMD, to incorporate all features necessary to support competition through demand-response and distributed generation.

There are several other elements of the SMD that must be addressed to develop an integrated demand-responsiveness program. Modular Software Designs are critically important.[50] SMD software should be transparent, testable and modular, and be capable of accommodating change.[51] Again, it is essential that SMD software be developed as necessary to support competition through demand-response and distributed generation.

The Regional Planning Process also must be focused upon demand-responsiveness. Michigan agrees that "market-driven decisions"[52] ought to be the basis for determining responses to needs for additional investment. In this respect, it is

---

[49] *Id.* at P 116.
[50] *Id.* at P 351, *et seq.*
[51] *Id.* at P 352.
[52] *Id.* at P 337.

imperative that demand response and distributed generation are provided the opportunity to participate.[53] Michigan supports the planning process that is described in paragraphs 346-347, but believes a substantial amount of work remains before anyone can provide assurance that the proposed planning process will be able to function effectively in that manner.

All available steps must be taken to make certain that the detailed operations of the planning process will be sufficient to insure full opportunities for demand response and distributed generation to meet infrastructure needs. Michigan recognizes that it will be necessary to establish mechanisms to insure fair and open competition amongst widely varying options with widely varying timelines for implementation. To meet this challenge, it is critical for the planning process to be developed so that fair and open competition can result and all options must be fully analyzed and compared, including additional transmission infrastructure, traditional central-station generation, distributed generation, and demand response.

The need to develop and consider demand-side options is particularly important with respect to the appropriate planning horizon. The planning process and horizon must

[53] *Id.* at P 337.

provide adequately for assessment of various demand-response options, which themselves have widely varying lead times. More detailed work remains to be done before market participants can be confident that a planning process can be developed and implemented which meets the vitally important goals required. This is critically important for the planning process, which must adequately identify system needs, and the associated processes of identifying options available to meet those needs and utilizing competitive market mechanisms to make sure that the preferred resources will be made available in the appropriate time frame.

Michigan notes that the relationship between rate design and demand-responsiveness is not directly addressed by SMD and is concerned that existing rate designs may discourage, rather than incent, demand response. Fair and open markets for demand response and distributed generation can be encouraged by eliminating traditional incentives to maintain and increase throughput on their transmission and distribution resources. While the States can take appropriate action on these incentives insofar as they relate to local distribution companies, the Commission has the role of examining the incentives for transmission providers and establishing market mechanisms that will mitigate the throughput incentive, where it remains.

Michigan notes that the existing policy of designing rates for existing network service by including "behind-the-meter" load serves as a disincentive to the development of distributive generation. The Commission should examine whether load which is served by generation located behind-the-meter should be excluded from the new network access rate design. Will the SMD, as proposed, establish a market design that provides sufficient competitive opportunities for demand response and distributed generation in such a way that those options can overcome the inherent resistance that transmission providers will have in responding to an incentive structure which rewards transmission providers based on throughput? Is there a way to achieve sufficient competition in electric markets by pitting various interested parties against one another, so that the throughput incentive that ultimately drives certain players is somehow counterbalanced by a different set of incentives which guide other players? Michigan believes this is a significant problem, which deserves serious attention in the SMD.

Michigan shares the Commission's concern that several of the classes typically represented in ISO stakeholder committees are fundamentally "interests that would benefit from higher levels of demand."[54] Michigan agrees that this "could discourage the introduction of changes that implement new demand management technologies and services…."[55] Again, Michigan raises the concern about the throughput incentive as it relates to transmission providers, and suggests that some attention should be given to exploring options to realign incentives to help make stakeholders less sensitive to demand levels, if not indifferent to them entirely. Furthermore, it is appropriate for ITPs to have adequate representation of stakeholder classes, explicitly including public interest groups, alternative energy providers, end-users, demand response providers, and retail energy providers; however, Michigan recognizes that such groups are often non-profit organizations, frequently small and with few discretionary resources which they can apply to participation in such activities on a voluntary basis. Michigan believes it is appropriate to consider some mechanisms that can be used to ensure adequate

[54] *Id.* at P 561.
[55] *Id.*

representation on the part of such interest groups, in a manner which does not disadvantage them.

Another area of the SMD related to demand-response is market monitoring. The functions of the autonomous market monitor will be important to identifying opportunities for distributed generation and demand response capability.[56] Michigan notes that the Commission's proposal is "to require each monitor to perform a structural analysis of the region" both "prior to the implementation of the Standard Market Design" and then annually thereafter.[57] Accordingly, special attention must be given to developing modeling capability, especially by providing standard, modular computer software, to support these activities.

Resource adequacy also relates to demand response in an important way. Existing concepts of resource adequacy were developed based on generally accepted ideas about the relative size and numbers of generators in a region and with little regard to distributed generation and demand response. Appropriate consideration and development of demand-response options could result in a smaller reserve margin in order to meet a given standard of resource adequacy. As previously stated, the Commission should suggest utilization of a 12 percent reserve margin as a temporary proxy – what the Commission calls a "safety-net level"[58] – but the appropriate levels for reserve margins should be reconsidered upon development of additional demand-side response. In addition, the Commission should allow sufficient flexibility for each RSAC to determine appropriate measures and levels of resource adequacy, based on regional needs.

---

[56] *Id.* at PP 434, 439.
[57] *Id.*

The Commission raises a specific question about methods for allocating "future adequacy requirements to loads."[59] This should be left to regional determination. However, the Commission has an important role to play in developing standard modular software components that can be used to support the RSACs with the modeling and analysis needed in order to make such determinations.

Michigan looks forward to the Commission's provision of an environmental assessment.[60] The electric power industry is presently the source of significant quantities of the nation's environmental impacts. It is critically important to understand the likely impacts SMD will have on our environment, and Michigan believes that, with the appropriate emphasis on demand-response options, SMD can and should have positive

---

[58] *Id.* at P 493.
[59] *Id.* at P 500.
[60] *Id.* at P 603.

effects on reducing the negative environmental impacts presently associated with the provision of electric power.

Respectfully submitted on behalf of:

STATE OF MICHIGAN and MICHIGAN PUBLIC SERVICE COMMISSION

____

Jennifer M. Granholm
Attorney General
of the State of Michigan

David A. Voges (P25143)
Steven D. Hughey (P32203)
Patricia S. Barone (P29560)
Assistant Attorneys General
6545 Mercantile Way, Suite 15
Lansing, Michigan 48911-5984
Phone (517) 241-6680

November 15, 2002